Internal Revenue
bulletin

Bulletin No. 1999–22
June 1, 1999

# HIGHLIGHTS OF THIS ISSUE

**These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.**

## EXEMPT ORGANIZATIONS

### Announcement 99–55, page 34.

A list is given of organizations now classified as private foundations.

## EMPLOYMENT TAX

### Page 3.

**Railroad retirement; rate determination; quarterly.** The Railroad Retirement Board has determined that the rate of tax imposed by section 3221 of the Code shall be 27 cents for the quarter beginning April 1, 1999.

## TAX CONVENTIONS

### Page 4.

The bilateral agreements between the United States and the Federal Democratic Republic of Ethiopia, providing for the reciprocal tax exemption of income from international operation of ships and/or aircraft, are set forth.

## ADMINISTRATIVE

### Notice 99–30, page 5.

This notice provides guidance on the tax relief under section 112 of the Code for United States military and support personnel involved in the military operations in the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel.

### REG–208156–91, page 11.

Proposed regulations describe how income from a long-term contract must be accounted for under section 460 of the Code. A public hearing is scheduled for September 14, 1999.

### REG–100905–97, page 10.

Proposed regulations under section 6049 of the Code relate to the elimination of the regulatory requirement that certain information be set forth on the face of a collateralized debt obligation (CDO) or regular interest in a Real Estate Mortgage Investment Conduit (REMIC). A public hearing is scheduled for September 13, 1999.

### Announcement 99–56, page 37.

The application period is open for membership on the Information Reporting Program Advisory Committee (IRPAC). The application questionnaires should be received by the Service no later than June 3, 1999.

**Finding Lists begin on page 42.**
**Index for January through May begins on page 45.**

Department of the Treasury
**Internal Revenue Service**

# Mission of the Service

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

**Part I.—1986 Code.**
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

**Part II.—Treaties and Tax Legislation.**
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

**Part III.—Administrative, Procedural, and Miscellaneous.**
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

**Part IV.—Items of General Interest.**
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.



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# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 3221.—Rate of Tax

### Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning April 1, 1999, shall be at the rate of 27 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning April 1, 1999, 36.9 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 63.1 percent of the taxes collected under such Sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated February 26, 1999.
By Authority of the Board

Beatrice Ezerski,
*Secretary of the Board.*

(Filed by the Office of the Federal Register on March 4, 1999, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1999, 64 F.R. 10729)

# Part II. Treaties and Tax Legislation

## Subpart A.—Tax Conventions

## Ethiopia

**Ministry of Finance**
**Federal Democratic Republic of Ethiopia**
**November 12, 1998**

The Ministry of Finance of the Federal Democratic Republic of Ethiopia presents its compliments to the Embassy of the United States of America and has the honor to refer to your letter of 29 May 1998; and we reply to the contents of the letter hereinabove mentioned.

We are glad to inform you that the Ministry of Finance, on behalf of the Federal Democratic Republic of Ethiopia, accepts the terms as detailed in your letter granting exemptions to income derived from the international operation of aircraft and ships and we do extend the same for aircraft and ships of the United States of America residents and corporations organized in the United States of America under the same term, insofar as such ships and aircraft meet the requirements of directives and other regulations issued by the Ministry of transport and communications under Article 18(5) of the Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia proclamation No. 4/1995.

This consent shall come into effect on the dates indicated in your letter of proposal.

The Ministry of Finance avails itself of this opportunity to assure to your Excellency its highest consideration and cooperation from it and all other matters.

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**Embassy of the United States of America**
**Federal Democratic Republic of Ethiopia**
**October 30, 1998**

The Embassy of the United States of America presents its compliments to the Ministry of Foreign Affairs of the Federal Democratic Republic of Ethiopia and has the honor to send to the Ministry a corrected version of the diplomatic note no. 254 dated May 29, 1998. The Government of the United States of America and the Government of the Federal Democratic Republic of Ethiopia conclude an agreement to exempt from income tax, on a reciprocal basis, income derived by residents of Ethiopia and the United States from the international operation of aircraft and ships. The terms of the agreement are as follows:

The Government of the United States of America, in accordance with sections 872(b) and 883(a) of the Internal Revenue Code, agrees to exempt from tax gross income derived from the international operation of aircraft and ships by Ethiopian residents and corporations organized in Ethiopia. This exemption is granted on the basis of equivalent exemptions granted by the Government of Ethiopia to United States individual residents and to corporations organized in the United States.

In the case of an Ethiopian corporation, the exemption shall apply only if the corporation meets the ownership or public trading requirements of Ethiopia.

Gross income includes all income derived from the international operation or chartering of aircraft or ships, including: (a) income from the rental on a full (time or voyage) basis of ships or aircraft used in international transport; (b) income from the rental on a bareboat basis of ships or aircraft used in international transport; (c) income from the rental of containers and related equipment used in international transport that is incidental to income from the international operation of ships or aircraft; and (d) gains from the sale or other alienation of ships or aircraft used in international transport by a person primarily engaged in the international operation of ships or aircraft.

If the proposals set out above are acceptable to the Government of the Federal Democratic Republic of Ethiopia, the Embassy, on behalf of the Government of the United States of America, proposes that this Note together with the Government of Ethiopia's note in reply, shall constitute an agreement between the Government of the United States of America and the Government of the Federal Democratic Republic of Ethiopia which shall enter into force on the date of the Government of the Federal Democratic Republic of Ethiopia's reply, and shall have effect with respect to taxable years beginning on or after January 1, 1998.

The Embassy of the United States of America avails itself of this opportunity to renew to the Ministry of Foreign Affairs of the Federal Democratic Republic of Ethiopia the assurances of its highest consideration.

# Part III. Administrative, Procedural, and Miscellaneous

## Tax Relief for Those Affected by Operation Allied Force

### Notice 99–30

**PURPOSE**

This notice provides guidance in a question and answer format on the tax relief provided under Executive Order No. 13119, 64 Fed. Reg. 18797 (April 16, 1999) (Executive Order), and the Act of April 19, 1999 (Act), Pub. L. No. 106–21, 113 Stat. 34 (1999), for U.S. military and support personnel involved in the military operations in the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel.

**BACKGROUND**

The Executive Order, effective March 24, 1999, designates the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel (including the airspace above these areas) as a combat zone for purposes of § 112 of the Internal Revenue Code.

The Act generally provides that, for purposes of certain provisions of the Code, a qualified hazardous duty area shall be treated in the same manner as if it were a combat zone under § 112. The Act defines the term "qualified hazardous duty area" to mean any area of the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the northern Ionian Sea (above the 39th parallel) if, as of the date of enactment of the Act, any member of the U.S. Armed Forces is entitled to special pay under section 310 of title 37, United States Code (relating to special pay: duty subject to hostile fire or imminent danger), for services performed in any of these areas, but only during the period the entitlement is in effect. On the date of the enactment of the Act, members of the U.S. Armed Forces were entitled to special pay for services performed in all these areas.

The provisions of the Code within the scope of the Act are as follows:

(1) Section 2(a)(3) (relating to the special rule where a deceased spouse was in missing status);

(2) Section 112 (relating to the exclusion from gross income of certain combat pay received by members of the U.S. Armed Forces);

(3) Section 692 (relating to income taxes of members of the U.S. Armed Forces on death);

(4) Section 2201 (relating to members of the U.S. Armed Forces dying in a combat zone or by reason of combat-zone-incurred wounds, etc.);

(5) Section 3401(a)(1) (defining wages relating to combat pay for members of the U.S. Armed Forces);

(6) Section 4253(d) (relating to taxation of phone service originating from members of the U.S. Armed Forces in a combat zone);

(7) Section 6013(f)(1) (relating to a joint return where an individual is in missing status); and

(8) Section 7508 (relating to the time for performing certain acts (including filing, paying, assessing, collecting, claiming a refund, and litigating) postponed by reason of service in a combat zone).

Under both the Executive Order and the Act, the deadline extension provisions under § 7508 apply to members of the U.S. Armed Forces (and those serving in support of the U.S. Armed Forces) in the combat zone or qualified hazardous duty area. Under the Act, during the period the special pay entitlement is in effect in the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the northern Ionian Sea (above the 39th parallel), the deadline extension provisions under § 7508 also apply to an individual in other areas who (1) is performing services as part of Operation Allied Force, (2) is outside the United States, *and* (3) is deployed away from that individual's permanent duty station.

The Act is generally effective on March 24, 1999, except for the modifications to the income tax withholding rules of § 3401(a)(1), which apply to amounts paid after April 19, 1999, the date of enactment of the Act.

This notice is in addition to the guidance provided under Notice 96–34, 1996–1 C.B. 379. Notice 96–34 provides tax relief under the Act of March 20, 1996, Pub. L. No. 104–117, 110 Stat. 827 (1996), for U.S. military and support personnel involved in the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia.

**QUESTIONS AND ANSWERS**

The following questions and answers generally apply to members of the U.S. Armed Forces on active duty and are patterned after the questions and answers in Notice 96–34, 1996–1 C.B. 379 (Tax Relief for Those Affected by Operation Joint Endeavor). Any reference in the following questions and answers to a "combat zone" also includes a "qualified hazardous duty area" that, under the Act, is treated as a combat zone. For additional information on the tax treatment of members of the U.S. Armed Forces including reservists, decedents, or persons missing in action, consult Publication 3, Armed Forces' Tax Guide.

**PART 1 – MILITARY PAY EXCLUSION**

Q-1: Which geographic areas are included in the combat zone covered by this notice?
A-1: The geographic areas included in the combat zone are the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the northern Ionian Sea above of the 39th parallel (including the airspace above these areas).

Q-2: I am a member of the U.S. Armed Forces assigned to perform services in the Adriatic Sea. Is any part of my 1999 military pay for serving in this area excluded from gross income?
A-2: Yes. The Adriatic Sea is in the combat zone. If you serve in the combat zone as an enlisted person for any part of a month, all your military pay received for military service that month is excluded from gross income. Commissioned officers have a similar exclusion, but it is limited to the maximum enlisted amount per month (currently $4,653). Amounts excluded from gross income are not subject to federal income tax.

Q-3: My husband and I are both enlisted personnel serving in the U.S. Armed Forces in the combat zone. Are we both entitled to the income tax exclusion for military pay?

A-3: Yes. Each of you qualifies for the income tax exclusion for your military pay.

Q-4: I am a member of the U.S. Armed Forces stationed in Italy. I fly missions over Yugoslavia as part of the military operations in the combat zone. Is any part of my military pay excluded from gross income?
A-4: Yes. You are serving in the combat zone. See Q & A 2 for a discussion of the amount of your military pay that is excluded.

Q-5: If I am injured and hospitalized while serving in the U.S. Armed Forces in the combat zone, is any of my military pay excluded from gross income?
A-5: Yes. Military pay received by enlisted personnel who are hospitalized as a result of injuries sustained while serving in the combat zone is excluded from gross income for the period of hospitalization, subject to the 2-year limitation provided below. Commissioned officers have a similar exclusion, but it is limited to the maximum enlisted amount per month. See Q & A 2. These exclusions from gross income for hospitalized enlisted personnel and commissioned officers end 2 years after the date of termination of the combat zone.

Q-6: My wife is currently serving in the U.S. Armed Forces in the combat zone and will be eligible for discharge when she returns home. If she is discharged upon her return, will the payment for the annual leave that she accrued during her service in the combat zone be excluded from gross income?
A-6: Yes. Annual leave payments made to enlisted members of the U.S. Armed Forces at the time of their discharge from the service are excluded from gross income to the extent the leave was accrued during any month in any part of which the member served in the combat zone. If your wife is a commissioned officer, a portion of the annual leave payment she receives for leave accrued during any month in any part of which she served in the combat zone may be excluded. The leave payment cannot be excluded to the extent it exceeds the maximum enlisted amount (see Q & A 2) for the month of service to which it relates less the amount of military pay already excluded for that month.

Q-7: My brother, who is a civilian in the merchant marine, is on a ship that transports military supplies between the United States and the combat zone. Is he entitled to the combat zone military pay exclusion?
A-7: No. Those serving in the merchant marine are not members of the U.S. Armed Forces. The combat zone military pay exclusion applies only to members of the U.S. Armed Forces. The U.S. Armed Forces include all regular and reserve components of the uniformed services that are under the control of the Secretaries of Defense, Army, Navy, and Air Force, as well as the Coast Guard.

Q-8: My husband is a member of the U.S. Armed Forces performing services as part of Operation Allied Force in Italy. He is not receiving hostile fire/imminent danger pay. Is he entitled to the military pay exclusion?
A-8: No. U.S. Armed Forces personnel serving outside the combat zone are not entitled to the military pay exclusion, unless they are serving in direct support of military operations in the combat zone for which they receive hostile fire/imminent danger pay. For a more detailed discussion of the tax treatment of military personnel, see Publication 3. For a discussion of possible extension of deadlines, see Q & A's 26 and 27.

**PART 2 – EXTENSION OF DEADLINES**

Q-9: I have been serving in the Adriatic Sea since April 1, 1999. I understand that the deadline for performing certain actions required by the internal revenue laws is extended as a result of my service. On what date did these deadline extensions begin?
A-9: The deadline extension provisions apply to most tax actions required to be performed on or after March 24, 1999, or the date you began serving in the combat zone, whichever is later. In your case, the date that the deadline extensions began is April 1, 1999.

Q-10: My son is a member of the U.S. Armed Forces who is now serving in the combat zone. Is he entitled to an extension of time for filing and paying his federal income taxes? Are any assessment or collection deadlines extended?
A-10: For both questions, the answer is yes. In general, the deadlines for performing certain actions applicable to his federal taxes are extended for the period of his service in the combat zone on or after March 24, 1999, plus 180 days thereafter. During this extension period, assessment and collection deadlines will be extended, and interest and penalties attributable to the extension period will not be charged.

Q-11: Assuming the same facts as in question 10, would my son still have an extension for filing and paying his federal individual income taxes if he has unearned income from investments?
A-11: Yes. The extension applies without regard to the source of your son's income.

Q-12: Assuming the same facts as in question 10, will the deadline extension provisions continue to apply if my son is hospitalized as a result of an injury sustained in the combat zone?
A-12: Yes. The deadline extension provisions will apply for the period that your son is continuously hospitalized outside of the United States as a result of injuries sustained while serving in the combat zone, including 180 days thereafter. For hospitalization inside the United States, the extension period cannot be more than 5 years.

Q-13: Do the deadline extension provisions apply only to members of the U.S. Armed Forces serving in the combat zone?
A-13: No. The deadline extension provisions also apply to individuals serving in the combat zone in support of the U.S. Armed Forces, such as Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the U.S. Armed Forces in support of those forces.

Q-14: My son is a civilian explosive specialist who is in the combat zone training U.S. Armed Forces personnel serving in the combat zone. Do the deadline extension provisions apply to my son?
A-14: Yes. The deadline extension provisions apply to your son because he is serving in the combat zone in support of the U.S. Armed Forces.

Q-15: My husband is a private businessman working in Albania on nonmilitary

projects. Do the deadline extension provisions apply to my husband?
A-15: No. Other than military personnel, the only individuals working in the combat zone that are entitled to the deadline extension provisions are those serving in support of the U.S. Armed Forces.

Q-16: I am a member of the U.S. Armed Forces serving in the combat zone. Do the deadline extension provisions apply to my husband who is in the United States?
A-16: Yes. The deadline extension provisions apply not only to members serving in the U.S. Armed Forces (or individuals serving in support thereof) in the combat zone, but to their spouses as well, with two exceptions. First, if you are hospitalized in the United States as a result of injuries received while serving in the combat zone, the deadline extension provisions would not apply to your husband. Second, the deadline extension provisions for your husband do not apply for any tax year beginning more than 2 years after the date of the termination of the combat zone designation.

Q-17: Assuming the same facts as in question 16, will my husband have to file a joint tax return in order to benefit from the deadline extension provisions?
A-17: No. The deadline extension provisions apply to both spouses whether joint or separate returns are filed. If your husband chooses to file a separate return, he will have the same extension of time to file and pay his taxes that you have.

Q-18: My husband is serving in the U.S. Armed Forces in the combat zone. In 1998, our son, who is 12 years old, received $700 of interest income. Our daughter, who is 17 years old, received $2,000 of earned income from part-time work and $900 of interest income. We claim both children as dependents on our federal individual income tax return. Are federal individual income tax returns required to be filed for our children while my husband is in the combat zone?
A-18: No. Federal individual income tax returns for your dependent children are not required to be filed while your husband is in the combat zone. Instead, these returns will be considered timely if filed on or before the deadline for filing your federal individual income tax return under the deadline extension provisions. The U.S. Armed Forces will provide your husband with instructions on how to notify the IRS of your children's eligibility to receive this extension of time to file. Since your older child may be entitled to a refund of tax, she may want to file her federal individual income tax return and obtain her refund.

Q-19: I am a member of the U.S. Armed Forces serving in the combat zone. My spouse and our three children live in our home in the United States. During 1998, a child care provider took care of our children in our home. We are required to file a Schedule H, Household Employment Taxes, as an attachment to our federal individual income tax return to report the federal employment taxes on wages we paid to our child care provider. Do the deadline extension provisions apply to the filing of Schedule H as an attachment to our federal individual income tax return?
A-19: Yes. The deadline extension provisions apply to all schedules and forms that are filed as attachments to the federal individual income tax return.

Q-20: I am a member of the U.S. Armed Forces who served in the combat zone beginning on March 24, 1999. If I serve in the combat zone until May 17, 1999, when will I be required to file my federal individual income tax return for 1998?
A-20: You must file your 1998 federal individual income tax return on or before December 6, 1999, 203 days after you left the combat zone. The deadline extension period consists of the sum of the following:

(1) 180 days from the date you left the area . . . . . . 180
(2) The number of days remaining (as of the date you entered the area) to perform the required act (in your case, filing your 1998 federal individual income tax return, 3/24/99 to 4/15/99). . . . . . 23
Total . . . . . . . . . . . . . . . . . . . . . . . 203

Q-21: My wife is a member of the U.S. Armed Forces serving in the combat zone. Can she make a timely qualified retirement contribution for 1998 to her individual retirement account (IRA) after April 15, 1999, and on or before the due date of her 1998 federal individual income tax return after applying the deadline extension provisions?
A-21: Yes. Your wife can make a timely qualified retirement contribution for 1998 to her IRA on or before the extended deadline for filing her 1998 income tax return under the deadline extension provisions.

Q-22: My brother, who began serving in the U.S. Armed Forces in the combat zone on March 24, 1999, did not make his first estimated tax payment for 1999 which was due April 15, 1999. Will my brother be liable for estimated tax penalties?
A-22: No. Your brother is covered by the deadline extension provisions and will not be liable for any penalties if he files and pays any tax due by his extended filing due date. The U.S. Armed Forces will provide your brother with instructions on how to notify the IRS of his eligibility to receive tax relief.

Q-23: My son, who is a member of the U.S. Armed Forces, was on an installment payment plan with the IRS for back income taxes before he was assigned to the combat zone. What should be done now that he is in the combat zone?
A-23: The IRS office where your son was making payments should be contacted. Because your son is serving in the combat zone, he will not have to make payments on his past due taxes for his period of service in the combat zone plus 180 days. No additional penalties or interest will be charged during the deadline extension period.

Q-24: My son, who is a member of the U.S. Armed Forces serving in the combat zone, will file his federal individual income tax return for 1998 after April 15, 1999, but on or before the end of the deadline extension for filing that return. He expects to receive a refund. Will the IRS pay interest on the refund?
A-24: Yes. The IRS will pay interest from April 15, 1999, on a refund issued to your son if he files his 1998 federal individual income tax return on or before the due date of that return after applying the deadline extension provisions. The U.S. Armed Forces will provide your son with instructions on how to notify the IRS of his eligibility to receive tax relief. If his 1998 return is not timely filed on or before the due date after applying the deadline extension provisions, no interest will be paid on the refund except as provided under the normal refund rules.

Q-25: Do the deadline extension provisions apply to federal tax returns other than the federal individual income tax return?
A-25: Yes. The deadline extension provisions also apply to federal estate and gift tax returns. However, the deadline extension provisions do not apply to other federal tax and information returns, such as those for corporate income tax or employment taxes.

Q-26: I am a member of the U.S. Army that was deployed to Italy to perform services as part of Operation Allied Force. My permanent duty station is in the United States where my spouse resides. Do the deadline extension provisions for filing and paying our federal individual income taxes apply to me?
A-26: Yes. Any member of the U.S. Armed Forces who is performing services as part of Operation Allied Force outside of the United States while deployed away from that individual's permanent duty station qualifies for the deadline extension for filing and paying federal individual income taxes. The deadline extension provisions also apply to that member's spouse.

Q-27: My husband, who is a member of the U.S. Armed Forces, is at his permanent duty station in Italy performing services as part of Operation Allied Force. Do the deadline extension provisions apply?
A-27: No. U.S. Armed Forces personnel serving at their permanent duty station outside the combat zone are not entitled to the deadline extension provisions. For a more detailed discussion of the tax treatment of military personnel, see Publication 3.

Q-28: I am a Department of Defense civilian employee stationed in Hungary away from my permanent duty station in the United States. I am performing services as part of Operation Allied Force. Do the deadline extension provisions apply to me?
A-28: Yes. The deadline extension provisions apply to you. Although you are not serving in the combat zone, you are a Department of Defense civilian employee performing services away from your permanent duty station as part of Operation Allied Force.

Q-29: My husband and I are civilian employees of defense contractors. I work in the United States and my husband temporarily works in Germany. Our jobs involve the production of equipment used by the U.S. Armed Forces for Operation Allied Force. Do the deadline extension provisions apply to either of us?
A-29: No. The deadline extension provisions do not apply to civilian employees of defense contractors unless they are serving in the combat zone in support of the U.S. Armed Forces.

**PART 3 – MISCELLANEOUS PROVISIONS**

Q-30: My daughter is a member of the U.S. Armed Forces serving in the combat zone. She makes calls to me here in the United States. Are these calls exempt from the federal excise tax on toll telephone service?
A-30: Yes. Telephone calls that originate within the combat zone and that are made by members of the U.S. Armed Forces serving there are exempt from the federal excise tax on toll telephone service. If a calling card or collect call is made, a certificate of exemption must be furnished to the telephone service provider receiving payment for the call. The exemption certificate (which may be obtained from the telephone service provider) should be signed and dated by the telephone subscriber and contain the following information: the amount and point of origin of the call, the name of the member of the U.S. Armed Forces performing service in the combat zone originating the call, the name of the telephone service provider, and a statement that the charges are exempt from tax under § 4253(d) of the Internal Revenue Code.

Q-31: If the federal excise tax has already been paid on the toll telephone service in Q & A 30, can a refund be obtained?
A-31: Yes. If the federal excise tax has already been paid on that toll telephone service, a refund may be obtained either from the telephone service provider that collected the tax, or from the IRS by filing Form 8849, Claim for Refund of Excise Taxes, and providing the exemption certificate described in A-30.

Q-32: How will my military pay for active service in the U.S. Armed Forces in the combat zone be reported on my 1999 Form W-2, Wage and Tax Statement?
A-32: Military pay attributable to your active service in the combat zone that is excluded from gross income will not be reported on your 1999 Form W-2 in the box marked "Wages, tips, other compensation." However, military pay for such service is subject to social security and medicare taxes and will be reported on your 1999 Form W-2 in the boxes marked "Social security wages" and "Medicare wages and tips."

Q-33: I'm an officer serving in the combat zone. I have made monthly contributions to an individual retirement account (IRA) for 1999. In view of the military pay exclusion for my service in the combat zone, I may have little or no taxable compensation for 1999 and may not be eligible to make an IRA contribution for 1999. If my taxable compensation is less than $2000, should I withdraw the portion of my contributions that exceeds my taxable compensation?
A-33: Yes. In general, any amount contributed to your IRA that is more than the smaller of (1) your taxable compensation, or (2) $2000, is an excess contribution and must be withdrawn to avoid a 6 percent excise tax. Once you are sure that your taxable compensation will be less than $2000, you should withdraw the portion of your contributions that exceeds your taxable compensation. You will not be taxed on the distributed amount if you receive the distribution on or before the deadline for filing your 1999 federal individual income tax return after applying the deadline extension provisions. You may not take a deduction with respect to these distributed contributions. You must also withdraw the amount of net income attributable to the distributed contributions while they were assets of the IRA. Any of that net income is includible in your gross income for 1999. For further information, see Publication 590, Individual Retirement Arrangements (IRAs) (Including Roth IRAs and Education IRAs).

Q-34: Assuming the same facts as question 33, how will the financial institution that distributes my 1999 IRA contributions to me report this distribution?
A-34: The financial institution will report the entire amount of the distribution

(1999 distributed contributions and attributable net income) on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. However, it should report only the amount of any net income attributable to the distributed contributions as the "Taxable amount" on Form 1099-R.

**PART 4 – INQUIRIES**

Taxpayers within the United States may seek assistance by calling the IRS at 1-800-829-1040.

The IRS offices in Rome, Italy, Bonn, Germany, Paris, France, and London, England, can also assist you with your federal income tax questions. You may contact the Rome office by calling [39] (06) 4674-2560, or via fax at [39] (06) 4674-2223; the Bonn office by calling [49] (228) 339-2119, or via fax at [49] (228) 339-2810; the Paris Office at (33) (1) 4312-2555, or via fax at (33) (1) 4312-4577; and the London Office at (44) (171) 408-8077, or via fax at (44) (171) 495-4224.

Taxpayers with access to e-mail may direct questions relating to the tax relief discussed in this notice to *Alliedforce@ccmail.irs.gov which is the IRS e-mail address for this information.

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Real Estate Mortgage Investment Conduits; Reporting Requirements and Other Administrative Matters

## REG–100905–97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document proposes to eliminate the regulatory requirement that certain information be set forth on the face of a collateralized debt obligation (CDO) or regular interest in a Real Estate Mortgage Investment Conduit (REMIC). Implementing the proposal should reduce the burden imposed on issuers of CDOs and regular interests without impairing the flow of tax information to either the holders of those instruments or the IRS. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by July 19, 1999. Outlines of topics to be discussed at the public hearing scheduled for September 13, 1999, at 10 a.m. must be received by August 23, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–100905–97), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–100905–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/reglist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Kenneth Christman, (202) 622-3950; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

*Background*

Final regulations (TD 8366, 1991–2 C.B. 18) imposing reporting requirements with regard to CDOs and REMIC regular interests were published in the **Federal Register** for September 30, 1991 (56 F.R. 49512, as corrected by 56 F.R. 51175). Among other things, those regulations compel the issuer of a CDO or REMIC regular interest to set forth certain information on the face of the instrument (legending). Several commentators have asked the IRS to reassess the need for this rule.

*Explanation of Provisions*

Section 1272(a)(6) of the Internal Revenue Code provides a special rule for calculating the accrual of original issue discount (OID) on REMIC regular interests and CDOs. Special rules are needed because the timing of payments on these instruments is often uncertain. Although CDOs and REMIC regular interests are issued with fixed maturity dates, they may be accelerated to the extent that obligations collateralizing them prepay.

Because the holder of a CDO or REMIC regular interest would not necessarily have the information needed to calculate OID under section 1272(a)(6), Congress added section 6049(d)(7) to require enhanced reporting for such instruments. In addition, Congress gave the IRS and Treasury specific authority to issue regulations carrying out that purpose. 2 H.R. Conf. Rep. 99th Cong. 2d Sess. II-237 (1986), 1986–3 (Vol. 4) C.B. 237.

The regulations issued under section 6049(d)(7) are comprehensive. Sections 1.6049–7(a) through 1.6049–7(f) establish a chain of reporting obligations that ensures essential tax information will flow to holders of CDOs and REMIC regular interests. The information made available includes the amount of a holder's OID accrued during the calendar year. Importantly, this information is updated annually.

In addition to the ongoing information reporting provided under §§ 1.6049–7(a) through 1.6049–7(f), Section 1.6049–7(g) provides for certain information to be legended on the face of a CDO or REMIC certificate when first issued. The information includes the total amount of OID on the instrument, the issue date, the rate at which interest is payable (if any) as of the issue date, and the yield to maturity.

Legending appears to provide little practical benefit. Most CDOs and REMIC regular interests are held through book-entry systems, which means the legended information is rarely (if ever) reported to the holders. Even if the information were reported, it would be of little use. Holders who are entitled to have OID determined for them do not need the information. Holders who need or want to determine OID themselves cannot make the necessary section 1272(a)(6) calculations without acquiring additional information. Furthermore, legended information is available through other sources. It can be obtained from vendors of financial information or requested under other section 6049 regulations. For these reasons, the IRS and Treasury propose to rescind § 1.6049–7(g).

Comments are invited on these proposed regulations. In particular, any taxpayers that rely on legended information are asked to specify the items relied on and suggest other ways to provide those items (such as including them among the items that must be reported under §§ 1.6049–7(a) through 1.6049-7(f)).

*Proposed Effective Date*

The rescission of § 1.6049-7(g) is proposed to be effective on the date the regulations are published in the **Federal Register** as final regulations.

*Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

*Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 13, 1999, beginning at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For further information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by August 23, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

*Drafting Information*

The principal author of these regulations is Kenneth Christman, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

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*Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

**§1.6049–7 [Amended]**

Par. 2. In § 1.6049–7, paragraph (g) is removed.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on May 18, 1999, 8:45 a.m., and published in the issue of the Federal Register for May 19, 1999, F.R. 27221)

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## Notice of Proposed Rulemaking and Notice of Public Hearing

## Accounting for Long-Term Contracts

## REG–208156–91

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations describing how income from a long-term contract must be accounted for under section 460 of the Internal Revenue Code, which was enacted by the Tax Reform Act of 1986. A taxpayer manufacturing or constructing property under a long-term contract will be affected by these proposed regulations. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written comments and outlines of oral comments to be presented at the public hearing scheduled for September 14, 1999, at 10 a.m. must be received by August 3, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–208156–91), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–208156–91), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in the IRS Auditorium, 7th Floor, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, John M. Aramburu or Leo F. Nolan II at (202) 622-4960; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Michael L. Slaughter of the Regulations Unit at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

*Paperwork Reduction Act*

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS

Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by July 6, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the **Internal Revenue Service,** including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §1.460–1(e)(4). The information collected in §1.460–1(e)(4) is required to notify the Commissioner of the taxpayer's decision to sever or aggregate one or more contracts under the regulations. This collection of information is mandatory. The likely respondents are for-profit entities.

Estimated total reporting burden: 50,000 hours.

Estimated average burden per respondent: 1 hour.

Estimated number of respondents: 50,000.

Estimated annual frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

*Background*

Section 460, which was enacted by section 804 of the Tax Reform Act of 1986 (1986 Act), Public Law 99–514 (100 Stat. 2085, 2358–2361), generally requires a taxpayer to determine the taxable income from a long-term contract using the percentage-of- completion method. Section 460 was amended by section 10203 of the Omnibus Budget Reconciliation Act of 1987, Public Law 100–203 (101 Stat. 1330, 1330–394); by sections 1008(c) and 5041 of the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3342, 3438–3439 and 3673–3676); by sections 7621 and 7811(e) of the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106, 2375–2377 and 2408-2409); by section 11812 of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388, 1388–534 to 1388–536); by sections 1702(h)(15) and 1704(t)(28) of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755, 1874, 1888); and by section 1211 of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 998–1000).

Section 460(h) directs the Secretary to prescribe regulations to the extent necessary or appropriate to carry out the purpose of section 460, including regulations to prevent a taxpayer from avoiding section 460 by using related parties, pass-through entities, intermediaries, options, and other similar arrangements.

*Explanation of Provisions*

1. *Overview*

Before the enactment of section 460, §1.451–3 of the Income Tax Regulations permitted a taxpayer to determine the income from a long-term contract using either the completed-contract method (CCM) or the percentage-of-completion method, in addition to the cash receipts and disbursements method, if otherwise permissible, or an accrual method. Under the CCM, a taxpayer does not report income until a contract is complete, even though payments are received in years prior to completion. The percentage-of-completion method, on the other hand, requires a taxpayer to recognize income according to the percentage of the contract that is completed during each taxable year.

Section 460 generally requires the income from a long-term contract to be determined using the percentage-of-completion method based on a cost-to-cost comparison (PCM). However, the income from certain exempt construction contracts still may be determined using the CCM, the exempt-contract percentage-of-completion method (EPCM), or any other permissible method. Contracts that are not long-term contracts must be accounted for using a permissible method of accounting other than a long-term contract method (i.e., a method other than the PCM, the CCM, or the EPCM). See section 446 and the regulations thereunder.

The IRS and Treasury Department provided guidance on section 460 in Notice 89–15 (1989–1 C.B. 634) and in Notice 87–61 (1987–2 C.B. 370). These proposed regulations generally incorporate the relevant provisions of §1.451–3 and the notices under section 460. However, these proposed regulations also modify and amplify certain rules provided in §1.451–3 and notices under section 460. Specifically, for example, these regulations provide an exception for de minimis construction activities, modify the contract completion rules, clarify the treatment of non-long-term contract activities, modify the severing and aggregating rules to emphasize pricing and to prevent severance by taxpayers of contracts accounted for using the PCM, clarify the consistency rule provided in Notice 89–15, provide an inventory exception to the related party rules, provide safe harbors for determining whether a manufactured item is unique, and modify the normal time to complete an item to conform to the production period in section 263A.

These proposed regulations will apply to any contract entered into on or after final regulations are published in the **Federal Register.**

2. *Definition of Long-Term Contract*

Under section 460(f), *long-term contract* generally means any contract for the manufacture, building, installation, or construction of property if the contract is not completed within the taxable year the taxpayer enters into the contract (contracting year). For this purpose, *manufacturing* concerns only personal property, and *building, installation*, and *construction* (construction) concern only real property.

Section 460 continues the policy established in §1.451–3(b)(1) of excluding a manufacturing contract from the definition of long-term contract unless the contract involves the manufacture of (1) a unique item of a type that is not normally included in the finished goods inventory of the taxpayer or (2) an item normally requiring more than 12 calendar months to complete, regardless of the duration of the contract.

A contract is a contract for the manufacture or construction of property if such activities are necessary for the taxpayer's contractual obligations to be fulfilled and are not complete when the parties enter into the contract. However, a contract is not a construction contract if it requires the provision of land by the taxpayer and the estimated total allocable contract costs attributable to the taxpayer's construction activities are less than 10 percent of the total contract price. This de minimis construction rule may affect the result of facts similar to those in *Foothill Ranch Company Partnership v. Commissioner,* 110 T.C. No. 8 (1998), in which the Tax Court concluded that the sale of land could be accounted for using the PCM since construction of buildings and improvements was necessary to fulfill the taxpayer's obligations under the sales agreements and those obligations were not completed in the tax year of the sale.

3. *Date Taxpayer Enters Into A Long-Term Contract*

The proposed regulations provide that a taxpayer enters into a long-term contract in the taxable year that the contract binds both the taxpayer and the customer under applicable law. If a taxpayer delays entering into a contract to avoid section 460, however, the taxpayer will be treated as having entered into the contract on the date the taxpayer or a related party incurs any allocable contract costs, other than bidding or negotiating costs. If a taxpayer must sever an accepted change order or exercised option from a long-term contract, the taxpayer enters into another contract with the customer when the change order is accepted by the taxpayer or when the option is exercised by the customer, whichever is applicable.

4. *Date Taxpayer Completes A Long-Term Contract*

The proposed regulations provide that a long-term contract is completed in the earlier taxable year (completion year) that: (1) the customer uses the subject matter for any purpose (other than testing) and 5 percent or less of the total allocable contract costs attributable to the subject matter remain to be incurred by the taxpayer; or (2) the subject matter of the contract is finally completed and accepted. A taxpayer must determine whether a contract has been finally completed and accepted during the taxable year based upon an analysis of all relevant facts and circumstances. To the extent that the "use" rule requires a taxpayer to treat a contract as completed before final completion and acceptance have occurred, the proposed regulations explicitly adopt a rule different from that considered in *Ball, Ball and Brosamer, Inc. v. Commissioner,* 964 F.2d 890 (9th Cir. 1992), *aff'g* T.C. Memo. 1990–454. In *Ball,* the Ninth Circuit held that the contract for construction of a space shuttle complex was not completed in 1983, notwithstanding that the performance report indicated the contract was 100 percent complete and the customer was using the subject matter for its intended purpose, since the remaining work to be done in 1984 (such as installing runway extensions, airfield lighting, drainage and a laser tracking system) was an integral part of the contract and the contract specifically provided that use was not deemed acceptance.

The regulations also provide that if a contract accounted for using the CCM requires the construction of a primary subject matter and a secondary subject matter, the contract is completed when the primary subject matter is completed. A taxpayer must separate the gross receipts and costs related to the incomplete secondary item(s) from the long-term contract and account for them using a permissible method of accounting.

5. *Non-Long-Term Contract Activities*

The performance of any activity other than manufacturing or construction is a non-long-term contract activity. If the performance of a non-long-term contract activity, such as engineering and designing, is incident to or necessary for the manufacture or construction of the subject matter of one or more of the taxpayer's long-term contracts, the taxpayer must allocate the gross receipts and costs attributable to that activity to the long-term contract(s) benefitted. Otherwise, the proposed regulations require the taxpayer to account for such gross receipts and costs using a permissible method of accounting other than a long-term contract method of accounting. See Rev. Rul. 82–134 (1982–2 C.B. 88) (engineering and construction management services); Rev. Rul. 80–18 (1980–1 C.B. 103) (engineering and construction management services); and Rev. Rul. 70–67 (1970–1 C.B. 117) (architectural services).

6. *Severing And Aggregating Contracts*

Section 460(f)(3) provides that the Secretary may prescribe regulations to treat two or more contracts which are interdependent as one contract and to respect a contract which is properly treated as an aggregation of separate contracts. The proposed regulations allow the Commissioner, and generally require a taxpayer, to sever and aggregate contracts when necessary to clearly reflect income.

The proposed rules provide three criteria for determining whether severance or aggregation is required. First, independent pricing of items is necessary for an agreement to be severed into two or more contracts. On the other hand, interdependent pricing of items in separate agreements is necessary for two or more agreements to be aggregated into one contract. Second, an agreement may not be severed into two or more contracts, unless it provides for separate delivery or separate acceptance of portions of the subject matter of the agreement. However, separate delivery or separate acceptance of portions of the subject matter of the agreement by itself does not necessarily require severance of the agreement. Third, an agreement may not be severed into two or more contracts if a reasonable businessperson would not have entered into separate agreements containing the terms allocable to each severed contract. Similarly, two or more agreements may not be aggregated into one contract, unless a reasonable businessperson would not have entered into one of the agreements for the terms agreed upon without also entering into the other agreement. The criteria adopted in the proposed regulations generally are consistent with the Tax Court's conclusions in *Sierracin Corporation v. Commissioner,* 90 T.C. 341 (1988), *acq.* 1990–2 C.B. 1, and *General Dynamics*

*Corporation v. Commissioner,* T.C. Memo 1997-420.

Under the proposed regulations, a taxpayer may not apply the severance rule described in the preceding paragraph if the entire contract would be accounted for using the PCM. However, the Commissioner may sever a contract accounted for using the PCM as necessary to clearly reflect income. In addition, a taxpayer must sever a long-term contract (not accounted for using the PCM) that increases the number of units to be supplied to the customer, such as through the exercise of an option or the acceptance of a "change order," if the contract provides for separate delivery or separate acceptance of the additional units.

7. *Classifying Long-Term Contracts*

The proposed regulations provide that a taxpayer's method of classifying contracts is a method of accounting. Thus, a taxpayer must request the consent of the Commissioner to change its method of classifying contracts. However, if the classification of a particular type of contract is no longer appropriate for subsequent contracts of that type as a result of a change in underlying facts, such as when a manufactured item no longer is unique due to a reduction in the extent of design or no longer requires 12 months to produce, a change in the classification of such subsequent contracts is not a change in method of accounting. To the extent that the consistency rule in Notice 89–15 (Q&A-7) was interpreted to prevent taxpayers from changing the classification of a particular type of subsequent contracts when the underlying facts have changed, the proposed regulations clarify the consistency rule.

Under the proposed regulations, a taxpayer must classify a contract that requires the taxpayer to manufacture personal property and to construct real property separately as a manufacturing and a construction contract, unless 95 percent or more of the estimated total allocable contract costs are reasonably allocable to the manufacturing activities or to the construction activities (in which case the taxpayer may chose to classify as either a manufacturing or a construction contract, as appropriate).

8. *Long-Term Contracts of Related Parties*

The proposed regulations contain rules similar to those in Notice 89–15 (Q&A-8) for an activity of a taxpayer that is incident to or necessary for a related party's long-term contract subject to PCM. The taxpayer must account for the gross receipts and costs from such an activity using the PCM, even if this activity is not otherwise subject to section 460. The proposed regulations contain an inventory exception for subassemblies and components sold to a related party, however, when the taxpayer regularly carries these items in its finished goods inventories and 80 percent or more of the gross receipts from the sale of these items typically comes from unrelated parties.

To determine the percentage of the contract that has been completed by the end of the taxable year (completion factor), the taxpayer with the long-term contract must take into account the related party's activity that is incident to or necessary for its long-term contract at the time it incurs the liability to the related party, rather than when the related party incurs costs to perform the activity.

9. *Unique Items*

Section 460 applies if a taxpayer manufactures a unique item of a type that is not normally included in the finished goods inventory of the taxpayer and if the contract is not completed by the close of the contracting year. As in §1.451–3(b)(1)(ii), the proposed regulations provide that unique means specifically designed for the needs of a customer. Thus, a contract may require the taxpayer to manufacture more than one unit of a unique item.

The proposed regulations contain three safe harbors concerning contracts to manufacture unique items. First, an item is not unique if the taxpayer normally completes the item within 90 days. Second, an item customized from a taxpayer's existing design is not unique if the total allocable contract costs attributable to customizing activities that are incident to or necessary for the production of the item does not exceed 5 percent of the estimated total costs allocable to the item. Thus, contracts to manufacture items that do not require either significant design or lengthy production periods ordinarily will not be subject to section 460. Third, a unique item ceases to be unique no later than when the taxpayer normally carries similar items in its finished goods inventory.

The proposed regulations adopt criteria different from those in *Sierracin, supra,* which was decided two years after the enactment of section 460, but concerned the taxpayer's use of the CCM for taxable years ending before the enactment of section 460. In *Sierracin,* the Tax Court developed a two-prong test for determining whether an item is unique. That test provided that an item is unique if (1) it is designed for the needs of a specific customer and (2) the taxpayer's contracts are subject to unpredictable manufacturing risks that make it difficult for the taxpayer to determine the ultimate profit or loss on an interim basis.

The regulations incorporate the *Sierracin* criterion regarding design, but exclude the criterion regarding unpredictable manufacturing risk because that criterion was developed primarily to justify the taxpayer's use of the CCM. See, e.g., GCM 7998 (IX-2 C.B. 206, 208); Rev. Rul. 70-67 (1970-1 C.B. 117); STAFF OF JOINT COMM. ON TAXATION, 99TH CONG., 1ST SESS., TAX REFORM PROPOSALS: ACCOUNTING ISSUES (JCS–39–86) 46 (Comm. Print 1985). Manufacturing risk is not relevant under the PCM because the taxpayer is required to use reasonable estimates, adjusted annually, while the contract is being performed and because the taxpayer is required to use the look-back method to correct for estimation errors when the contract is completed. Thus, the rationale supporting the consideration of manufacturing risk as a prerequisite to the use of the CCM, that the taxpayer is unable to determine its total contract costs, is not applicable to contracts subject to the PCM.

10. *12-Month Completion Period*

The proposed regulations provide that a manufactured item normally requires more than 12 months to complete if its production period, as defined in §1.263A–12, is reasonably expected to exceed 12 months, determined at the end of the contracting year. In general, the production period for an item or unit begins when the taxpayer's incurs at least 5 percent of the estimated total allocable contract costs, including planning and design expenditures, allocable to the item or unit, and the production period ends when the item or unit is ready for shipment to the taxpayer's customer. In the case of components that have to be assembled or reassembled into an item or unit at the customer's facility by the taxpayer's employees or agents, the production period ends when the components are assembled or reassembled into an operable item or unit.

For this purpose, the proposed regulations contain rules requiring a taxpayer to treat the activities of a related party as the activities of the taxpayer to prevent the taxpayer from avoiding section 460. However, if the inventory exception discussed in paragraph 8 above is satisfied, a taxpayer considers the activities of a related party as it incurs the liability to the related party rather than as the related party performs the activity.

11. *Definition Of Construction Contract*

Section 460(e)(4) and the proposed regulations provide that a *construction contract* is any contract for the building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvements of, real property. Thus, a contract to install an integral component to real property can be subject to section 460 even if the installation activity is not accompanied by any other construction activity.

12. *Exempt Construction Contracts*

Section 460(e)(1) exempts two types of construction contracts from the general scope of section 460. These exempt construction contracts are: (1) home construction contracts and (2) 2-year construction contracts of a small contractor. A small contractor is a taxpayer that satisfies the $10,000,000 gross receipts test discussed below. The 2-year construction requirement is satisfied if the taxpayer reasonably estimates, when entering into the contract, that the contract will be completed within 2 years from the contract commencement date.

13. *Home Construction Contracts*

Section 460(e)(6) provides that a construction contract is a home construction contract if the taxpayer (including a subcontractor working for a general contractor) reasonably expects to attribute 80 percent or more of the estimated total contract costs, determined at the close of the contracting year, to the construction of (1) a dwelling unit or a building containing four or fewer dwelling units and (2) improvements to real property directly related to the dwelling units and located on the site of the dwelling units. For this purpose, a *dwelling unit* means a house or an apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, or other establishment more than one-half of the units in which are used on a transient basis. In addition, a taxpayer must treat each townhouse or rowhouse as a separate building. The proposed regulations provide that a taxpayer includes in the cost of the dwelling units their allocable share of the cost of any common improvements (e.g., sewers, roads, clubhouses) that benefit the dwelling unit and that the taxpayer is contractually obligated, or required by law, to construct within the tract or tracts of land containing the dwelling units.

14. *$10,000,000 Gross Receipts Test*

Section 460(e)(1)(B)(ii) provides that the $10,000,000 gross receipts test is satisfied if the taxpayer's average annual gross receipts for the three taxable years preceding the contracting year do not exceed $10,000,000. For this purpose, section 460(e)(2) mandates the aggregation of gross receipts of all trades or businesses under common control with the taxpayer. Section 460(e)(2) also provides that the Secretary shall prescribe regulations providing attribution rules that take into account taxpayers who engage in construction contracts through partnerships, joint ventures, and corporations.

The proposed regulations require the aggregation of gross receipts under the common control rules in §1.263A-3(b)(3), other than the rules applicable to single employers under section 414(m) and the regulations thereunder. In addition, the regulations require the attribution of construction-related gross receipts of persons that own, or are owned by, the taxpayer, but that are not subject to §1.263A–3(b)(3). These rules are similar to those that applied to the $25,000,000 gross receipts test under prior law.

15. *Accounting For Long-Term Contracts—In General*

The proposed regulations prescribe permissible methods of accounting for long-term contracts subject to section 460(a). A taxpayer must use the PCM and may elect to use the 10-percent method. In addition, the regulations prescribe permissible methods of accounting for exempt construction contracts (exempt contract methods). Permissible exempt contract methods of accounting include the PCM, the EPCM, the CCM, or any other permissible method.

Section 460(e)(5) allows a taxpayer to determine the income from a residential construction contract using the percentage-of-completion/capitalized-cost method (PCCM). A taxpayer also may determine the income from a qualified ship contract using the PCCM. Under this method, a taxpayer must determine the income from the long-term contract using the PCM for the applicable percentage and using its exempt contract method for the remaining percentage of the contract.

The proposed regulations reserve on the accounting for mid-contract change in taxpayers. The IRS and Treasury Department request comments regarding the treatment of transfers of long-term contracts prior to completion.

16. *Percentage-of-Completion Method*

The proposed regulations provide that under the PCM, a taxpayer generally includes a portion of the total contract price in income for each taxable year that the taxpayer incurs contract costs allocable to the long-term contract. To determine the income from a long-term contract, the taxpayer first computes the *completion factor* for the contract, which is the percentage of the estimated total allocable contract costs that the taxpayer has incurred (based on the all events test of section 461, including economic performance, regardless of the taxpayer's method of accounting) through the end of the taxable year. Second, the taxpayer computes the amount of *cumulative gross receipts* from the contract by multiplying the completion factor by the *total contract price*, which is the amount that the taxpayer reasonably expects to receive under the contract. Third, the taxpayer computes the amount of *current-year gross receipts*, which is the difference between the cumulative gross receipts for the current taxable year and the cumulative gross receipts for the immediately preceding taxable year. This difference may be a loss (a negative number) if a taxpayer has overstated its completion factor for the immediately preceding taxable year. Fourth, the taxpayer takes into account both the current-year gross receipts and the amount of allocable contract costs actually incurred during the taxable year. To the extent any portion of the total contract price has not been included in taxable income by the completion year, section 460(b)(1) and the proposed regulations require the taxpayer to include that portion in income for the taxable year following the completion year.

Under the proposed regulations, total contract price includes all bonuses, awards, and incentive payments if it is reasonably estimated that they will be received, even if the all events test has not yet been met. If, by the end of the completion year, a taxpayer cannot reasonably estimate whether a contingency will be satisfied, the bonus, award, or incentive payment is not includible in total contract price. If it is determined after the taxable year following the completion year that an amount included in total contract price will not be earned, the taxpayer should deduct that amount in the year of the determination.

The proposed regulations provide that allocable contract costs under the PCM are determined using either of the following prescribed cost allocation methods—a method based on the extended period contract allocation rules in §1.451–3(d)(6) or the simplified cost-to-cost method.

17. *10-Percent Method*

Section 460 generally permits a taxpayer to elect to delay the application of the PCM to each long-term contract until the taxable year the taxpayer has incurred at least 10 percent of the estimated total allocable contract costs. Once elected, the 10-percent method applies to all of the taxpayer's long-term contracts entered into during and after the election year. Under section 460(b)(5), however, a taxpayer may not elect the 10-percent method if the taxpayer determines allocable direct and indirect costs using the simplified cost-to-cost method.

18. *Cost Allocation Rules*

Section 460(c) provides cost allocation rules for long-term contracts subject to the PCM. Section 460(c)(1) provides generally that all costs which directly benefit, or are incurred by reason of, the long-term contract activities of the taxpayer must be allocated to the long-term contract in the same manner as costs are allocated to extended-period long-term contracts under section 451 and the regulations thereunder (§1.451–3(d)(6) through (9)). Section 460(c)(2), however, also requires a taxpayer to allocate costs identified under a cost-plus long-term contract or a federal long-term contract even if these costs would not be allocable under the cost allocation rules for extended-period long-term contracts. In addition, section 460(c)(3) requires a taxpayer to allocate interest expense to a long-term contract (whether or not the contract is subject to the PCM) as if the rules of section 263A(f) (concerning the allocation of interest costs to property produced by the taxpayer) apply. Finally, sections 460(c)(4) and (5) describe costs that generally are not allocable to long-term contracts.

Because many taxpayers subject to the cost allocation rules of section 460 also are subject to the cost allocation rules of section 263A for non-long-term contracts, and because the cost allocation rules of section 263A generally follow the cost allocation rules applicable to extended-period long-term contracts, the proposed regulations provide that a taxpayer generally must allocate costs to a contract subject to section 460(a) in the same manner as direct and indirect costs are capitalized to property produced by a taxpayer under section 263A. The regulations provide exceptions, however, that reflect the differences in the cost allocation rules of sections 263A and 460.

19. *Simplified Cost-To-Cost Method*

The proposed regulations permit a taxpayer to elect to allocate contract costs using the simplified cost-to-cost method. Under the simplified cost-to-cost method, a taxpayer must determine a contract's completion factor based upon only direct material costs; direct labor costs; and depreciation, amortization, and cost recovery allowances on equipment and facilities directly used to manufacture or construct property under the contract. A taxpayer may allocate costs using the simplified cost-to-cost method only if the taxpayer determines the taxable income from all long-term contracts using the PCM.

20. *Cost Allocation Rules For Exempt Construction Contracts*

The proposed regulations, which supersede §1.451–3(d) (concerning the CCM), provide cost allocation rules for exempt construction contracts accounted for using the CCM. These rules provide that a taxpayer may allocate direct and indirect contract costs in the same way as currently required under §1.451–3(d)(5) for long-term contracts that are not extended-period long-term contracts. The regulations also permit a taxpayer to allocate indirect costs as provided in section 263A. A homebuilder, however, is required to capitalize the costs of its home construction contracts under section 263A and the regulations thereunder, unless the contract will be completed within 2 years of the contract commencement date and the taxpayer satisfies the $10,000,000 gross receipts test previously discussed.

21. *Alternative Minimum Taxable Income*

Section 56 generally requires a taxpayer (not exempt under section 55(e)) to determine the amount of alternative minimum taxable income (AMTI) from a long-term contract using the PCM. Though section 56(a)(3) excludes all home construction contracts from this requirement, the Internal Revenue Code does not exclude the exempt construction contracts of a small contractor, residential construction contracts, or qualified ship contracts. Section 56(a)(3) requires a small contractor to use the simplified cost-to-cost method to determine the completion factor of an exempt construction contract when computing AMTI.

Because the Code sometimes requires a taxpayer to compute AMTI and taxable income using different rules, a taxpayer generally must determine a contract's completion factor using the AMTI-modified, cost-to-cost PCM. The proposed regulations adopt the provisions of section IX of Notice 87–61, which permit a taxpayer to elect to determine a contract's completion factor for AMTI purposes using the accounting and cost allocation methods used to compute regular taxable income. A taxpayer is required, however, to comply with section 55 when computing AMTI.

22. *Changes in Method Of Accounting*

For the first taxable year that includes the date these regulations are published as final regulations in the **Federal Register,** the proposed regulations generally grant a taxpayer consent to change its method of accounting to comply with the provisions of these regulations for contracts entered into on or after the date these regulations are published as final regulations in the **Federal Register.** Because this change is made on a cutoff basis, a section 481(a) adjustment is not required.

23. *Request For Comments*

The IRS and Treasury Department invite comments regarding the application and effectiveness of the de minimis construction rule. The IRS and Treasury Department also welcome comments concerning the application of the unique-item rule, including the usefulness and terms of the safe harbors and approaches for determining when an item will cease being unique. Comments are requested concerning the 12-month production period rule, especially with respect to the application of §1.263A–12 and consideration of related party activities.

*Proposed Effective Date*

These regulations are proposed to be effective for contracts entered into on or after the date they are published in the **Federal Register** as final regulations.

*Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It is hereby certified that the collection of information in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities. The regulations require a taxpayer to attach a statement to its original Federal income tax return if the taxpayer severs or aggregates a long-term contract. The statement is needed so the Commissioner can determine whether the taxpayer properly severed or aggregated the contract. It is uncommon for a taxpayer that has a long-term contract to sever or aggregate that contract. In addition, if a contract is severed or aggregated and a statement is required, it is estimated that it will, on average, only take one hour to complete.

*Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 14, 1999, at 10 a.m. in the IRS Auditorium, 7th Floor, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenue, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies by August 3, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

*Drafting Information*

The principal author of these proposed regulations is Leo F. Nolan II, Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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*Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation is amended by removing the entry for §1.460–4 and adding the following entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§1.460–1 also issued under 26 U.S.C. 460(h).

§1.460–2 also issued under 26 U.S.C. 460(h).

§1.460–3 also issued under 26 U.S.C. 460(h).

§1.460–4 also issued under 26 U.S.C. 460(h) and 1502.

§1.460–5 also issued under 26 U.S.C. 460(h). * * *

**§1.4646 [Amended]**

Par. 2. Section 1.446-1 is amended as follows:

1. In the second sentence of paragraph (c)(1)(iii), the language "451" is removed and "460" is added in its place.

2. In the fourth sentence of paragraph (e)(2)(ii)(a), the language "§1.451–3" is removed and "§1.460–4" is added in its place.

**§1.451–3 [Removed]**

Par. 3. Section 1.451–3 is removed.

**§1.451–5 [Amended]**

Par. 4. Section 1.451–5 is amended, in the first sentence of paragraph (b)(3), by removing the language "§1.451–3" and adding "§1.460–4" in its place.

Par. 5. Section 1.460–0 is amended by:

1. Revising the introductory text.
2. Revising the entries for §§1.460–1 through 1.460–3, 1.460–4(a)-(i), and 1.460–5.
3. Revising the entry for §1.460–6(c)(4)(iv).
4. Removing the entries for §§1.460–7 and 1.460–8.

The revisions read as follows:

*§1.460-0 Outline of regulations under section 460.*

This section lists the paragraphs contained in §1.460–1 through §1.460–6.

*§1.460–1 Long-term contracts.*

(a) Overview.
(1) In general.
(2) Exceptions to required use of PCM.
(i) Exempt construction contract.
(ii) Qualified ship or residential construction contract.
(b) Definitions.
(1) Long-term contract.
(2) Contract for the manufacture, building, installation, or construction of property.
(i) In general.
(ii) *De minimis* construction activities.
(3) Allocable contract costs.
(4) Related party.
(5) Contracting year.
(6) Completion year.
(7) Contract commencement date.
(8) Incurred.
(c) Entering into and completing long-term contracts.
(1) In general.
(2) Date contract entered into.
(i) In general.
(ii) Options and change orders.
(3) Date contract completed.
(i) In general.
(ii) Secondary items.
(iii) Subcontracts.
(iv) Final completion and acceptance.
(A) In general.
(B) Contingent compensation.
(C) Assembly or installation.
(D) Disputes.
(d) Allocation among activities.
(1) In general.
(2) Non-long-term contract activity.
(e) Severing and aggregating contracts.
(1) In general.
(2) Facts and circumstances.
(i) Independent pricing.
(ii) Interdependent pricing.
(iii) Separate delivery or acceptance.
(iv) Reasonable businessperson.
(3) Exceptions.
(i) No severance for PCM.
(ii) Options and change orders.
(4) Statement with return.
(f) Classifying contracts.
(1) In general.
(2) Hybrid contracts.
(3) Method of accounting.
(4) Use of estimates.
(i) Estimating length of contract.
(ii) Estimating allocable contract costs.
(g) Special rules for activities benefitting long-term contracts of a related party.
(1) Related party use of PCM.
(i) In general.
(ii) Inventory exception.
(2) Total contract price.
(3) Completion factor.
(h) Effective date.
(1) In general.
(2) Change in method of accounting.
(i) [Reserved]
(j) Examples.

*§1.460–2 Long-term manufacturing contracts.*

(a) In general.
(b) Unique.
(1) In general.
(2) Safe harbors.
(i) Short production period.
(ii) Customized item.
(iii) Inventoried item.
(c) Normal time to complete.
(1) In general.
(2) Production by related parties.
(d) Qualified ship contracts.
(e) Examples.

*§1.460–3 Long-term construction contracts.*

(a) In general.
(b) Exempt construction contracts.
(1) In general.
(2) Home construction contract.
(i) In general.
(ii) Townhouses and rowhouses.
(iii) Common improvements.
(iv) Mixed use costs.
(3) $10,000,000 gross receipts test.
(i) In general.
(ii) Single employer.
(iii) Attribution of gross receipts.
(c) Residential construction contracts.

*§1.460–4 Methods of accounting for long-term contracts.*

(a) Overview.
(b) Percentage-of-completion method.
(1) In general.
(2) Computations.
(3) Post-completion-year income.
(4) Total contract price.
(i) In general.
(A) Definition.
(B) Contingent compensation.
(C) Non-long-term contract activities.
(ii) Estimating total contract price.
(5) Completion factor.
(i) Allocable contract costs.
(ii) Cumulative allocable contract costs incurred.
(iii) Estimating total allocable contract costs.
(iv) Pre-contracting-year costs.
(v) Post-completion-year costs.
(6) 10-percent method.
(i) In general.
(ii) Election.
(c) Exempt contract methods.
(1) In general.
(2) Exempt-contract percentage-of-completion method.
(i) In general.
(ii) Determination of work performed.
(d) Completed-contract method.
(1) In general.
(2) Post-completion-year income and costs.
(3) Gross contract price.
(4) Contracts with disputed claims.
(i) In general.
(ii) Taxpayer assured of profit or loss.
(iii) Taxpayer unable to determine profit or loss.
(iv) Dispute resolved.
(e) Percentage-of-completion/capitalized-cost method.
(f) Alternative minimum taxable income.

(1) In general.
(2) Election to use regular completion factors.
(g) Method of accounting.
(h) Examples.
(i) Mid-contract change in taxpayer. [Reserved]

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*§1.460–5 Cost allocation rules.*

(a) Overview.
(b) Cost allocation method for contracts subject to PCM.
(1) In general.
(2) Special rules.
(i) Direct material costs.
(ii) Components and subassemblies.
(iii) Simplified production methods.
(iv) Costs identified under cost-plus long-term contracts and federal long-term contracts.
(v) Interest.
(A) In general.
(B) Production period.
(C) Application of section 263A(f).
(vi) Research and experimental expenses.
(vii) Service costs.
(A) Simplified service cost method.
(1) In general.
(2) Example.
(B) Jobsite costs.
(C) Limitation on other reasonable cost allocation methods.
(c) Simplified cost-to-cost method.
(1) In general.
(2) Election.
(d) Cost allocation rules for exempt construction contracts reported using CCM.
(1) In general.
(2) Indirect costs.
(i) Indirect costs allocable to exempt construction contracts.
(ii) Indirect costs not allocable to exempt construction contracts.
(3) Large homebuilders.
(e) Cost allocation rules for contracts subject to the PCCM.
(f) Special rules applicable to costs allocated under this section.
(1) Nondeductible costs.
(2) Costs incurred for non-long-term contract activities.
(g) Method of accounting.

*§1.460-6 Look-back method.*

* * * * *

(c) * * *
(4) * * *
(iv) Additional interest due on look-back interest only after tax liability due.

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Par. 6. Sections 1.460– through 1.460–3 are revised to read as follows:

*§1.460–1 Long-term contracts.*

(a) *Overview*—(1) *In general.* This section provides rules for determining whether a contract for the manufacture, building, installation, or construction of property is a long-term contract under section 460 and what activities must be accounted for as a single long-term contract. Specific rules for long-term manufacturing and construction contracts are provided in §§1.460–2 and 3, respectively. A taxpayer generally must determine the income from a long-term contract using the percentage-of-completion method described in §1.460–4(b) (PCM) and the cost allocation rules described in §1.460–5(b) or (c). In addition, after a contract subject to the PCM is completed, a taxpayer generally must apply the look-back method described in §1.460–6 to determine the amount of interest owed on any hypothetical underpayment of tax, or earned on any hypothetical overpayment of tax, attributable to accounting for the long-term contract under the PCM.

(2) *Exceptions to required use of PCM*—(i) *Exempt construction contract.* The requirement to use the PCM does not apply to any exempt construction contract described in §1.460–3(b). Thus, a taxpayer may determine the income from an exempt construction contract using any accounting method permitted by §1.460–4(c) and, for contracts accounted for using the completed-contract method (CCM), any cost allocation method permitted by §1.460–5(d).

(ii) *Qualified ship or residential construction contract.* The requirement to use the PCM applies only to a portion of a *qualified ship contract* described in §1.460–2(d) or *residential construction contract* described in §1.460–3(c). A taxpayer generally may determine the income from a qualified ship contract or residential construction contract using the percentage-of-completion/capitalized-cost method (PCCM) described in §1.460–4(e), but must use a cost allocation method described in §1.460–5(b) for the entire contract.

(b) *Definitions*—(1) *Long-term contract.* A *long-term contract* generally is any contract for the manufacture, building, installation, or construction of property if the contract is not completed within the contracting year, as defined in paragraph (b)(5) of this section. However, a contract for the manufacture of property is a long-term contract only if it also satisfies either the unique item or 12-month requirements described in §1.460–2. A contract for the manufacture of personal property is a *manufacturing contract.* In contrast, a contract for the building, installation, or construction of real property is a *construction contract.*

(2) *Contract for the manufacture, building, installation, or construction of property*—(i) *In general.* A contract is a *contract for the manufacture, building, installation, or construction of property* if the manufacture, building, installation, or construction of the subject matter of the contract is necessary for the taxpayer's contractual obligations to be fulfilled and if the manufacture, building, installation, or construction has not been completed when the parties enter into the contract. Whether the customer has title to, or control over, the property (or bears the risk of loss from the property) is not relevant. Furthermore, how the parties characterize their agreement (e.g., as a contract for the sale of property) is not relevant.

(ii) *De minimis construction activities.* Notwithstanding paragraph (b)(2)(i) of this section, a contract is not a construction contract for purposes of section 460 if the contract includes the provision of land by the taxpayer and the estimated total allocable contract costs, as defined in paragraph (b)(3) of this section, attributable to the taxpayer's construction activities are less than 10 percent of the contract's total contract price, as defined in §1.460–4(b)(4)(i). For this purpose, a contract's estimated total allocable contract costs include a proportionate share of the estimated cost of any common improvement that benefits the subject matter of the contract if the taxpayer is contractually obligated, or required by law, to construct the common improvement.

(3) *Allocable contract costs. Allocable contract costs* are costs that are allocable to a long-term contract under §1.460–5.

(4) *Related party.* A *related party* is a person whose relationship to a taxpayer is described in section 707(b) or 267(b), determined without regard to section 267(f)(1)(A) and determined by substituting "at least 80 percent" for "more than 50 percent" with regard to the ownership of the stock of a corporation in sections 267(b)(2), (8), (10)(A), and (12).

(5) *Contracting year.* The *contracting year* is the taxable year in which a taxpayer enters into a contract as described in paragraph (c)(2) of this section.

(6) *Completion year.* The *completion year* is the taxable year in which a taxpayer completes a contract as described in paragraph (c)(3) of this section.

(7) *Contract commencement date.* The *contract commencement date* is the date that a taxpayer or related party first incurs any allocable contract costs, such as design and engineering costs, other than expenses attributable to bidding and negotiating activities. Generally, the contract commencement date is relevant in applying §1.460–6(b)(3) (concerning the de minimis exception to the look-back method under section 460(b)(3)(B)); §1.460–5(b)(2)(v)(B)(*1*)(*i*) (concerning the production period subject to interest allocation); §1.460–2(d) (concerning qualified ship contracts); and §1.460–3(b)(1)(ii) (concerning the construction period for exempt construction contracts).

(8) *Incurred. Incurred* has the meaning given in §1.461–1(a)(2) (concerning the taxable year of deduction under the accrual method of accounting), regardless of a taxpayer's overall method of accounting. See §1.461–4(d)(2)(ii) for economic performance rules concerning the PCM.

(c) *Entering into and completing long-term contracts*—(1) *In general.* To determine when a contract is entered into under paragraph (c)(2) of this section, and when a contract is completed under paragraph (c)(3) of this section, a taxpayer must consider all relevant activities performed by itself, by related parties, and by the customer, that are incident to or necessary for the long-term contract. In addition, to determine whether a contract is completed in the contracting year, the taxpayer may not consider when it expects to complete the contract.

(2) *Date contract entered into*—(i) *In general.* A taxpayer enters into a contract on the date that the contract binds both the taxpayer and the customer under applicable law, even if the contract is subject to unsatisfied conditions not within the taxpayer's control (such as obtaining financing). If a taxpayer delays entering into a contract for a principal purpose of avoiding section 460, however, the taxpayer will be treated as having entered into a contract not later than the contract commencement date.

(ii) *Options and change orders.* A taxpayer enters into a new contract on the date that the customer exercises an option or similar provision in a contract if that option or similar provision must be severed from the contract under paragraph (e) of this section. Similarly, a taxpayer enters into a new contract on the date that it accepts a change order or other similar agreement if the change order or other similar agreement must be severed from the contract under paragraph (e) of this section.

(3) *Date contract completed*—(i) *In general.* A taxpayer's contract is completed upon the earlier of–

(A) Use of the subject matter of the contract by the customer (other than for testing) and at least 95 percent of the total allocable contract costs attributable to the subject matter have been incurred by the taxpayer; or

(B) Final completion and acceptance of the subject matter of the contract.

(ii) *Secondary items.* The date a contract accounted for using the CCM is completed is determined without regard to whether one or more secondary items have been used or finally completed and accepted. If any secondary items are incomplete at the end of the taxable year in which the primary subject matter of a contract is completed, the taxpayer must separate the portion of the gross contract price and the allocable contract costs attributable to the incomplete secondary item(s) from the completed contract and account for them using a permissible method of accounting. A permissible method of accounting includes a long-term contract method of accounting only if a separate contract for the secondary item(s) would be a long-term contract, as defined in paragraph (b)(1) of this section.

(iii) *Subcontracts.* In the case of a subcontract, the subject matter of the subcontract is the relevant subject matter under paragraph (c)(3)(i) of this section.

(iv) *Final completion and acceptance*—(A) *In general.* Except as otherwise provided in this paragraph (c)(3)(iv), to determine whether final completion and acceptance of the subject matter of a contract have occurred, a taxpayer must consider all relevant facts and circumstances. Nevertheless, a taxpayer may not delay the completion of a contract for the principal purpose of deferring federal income tax.

(B) *Contingent compensation.* Final completion and acceptance is determined without regard to any contractual term that provides for additional compensation that is contingent on the successful performance of the subject matter of the contract. A taxpayer must account for all contingent compensation that is not includible in total contract price under §1.460–4(b)(4)(i), or in gross contract price under §1.460–4(d)(3), using a permissible method of accounting. For application of the look-back method for contracts accounted for using the PCM, see §1.460–6(c)(1)(ii) and (2)(vi).

(C) *Assembly or installation.* Final completion and acceptance is determined without regard to whether the taxpayer has an obligation to assist or supervise assembly or installation of the subject matter of the contract where the assembly or installation is not performed by the taxpayer or a related party. A taxpayer must account for the gross receipts and costs attributable to such an obligation using a permissible method of accounting, other than a long-term contract method.

(D) *Disputes.* Final completion and acceptance is determined without regard to whether a dispute exists at the time the taxpayer tenders the subject matter of the contract to the customer. For contracts accounted for using the CCM, see §1.460–4(d)(4). For application of the look-back method for contracts accounted for using the PCM, see §1.460–6(c)(1)(ii) and (2)(vi).

(d) *Allocation among activities*—(1) *In general.* Long-term contract methods of accounting (the PCM, the CCM, the PCCM, and the exempt-contract percentage-of-completion method (EPCM)) apply only to the gross receipts and costs attributable to long-term contract activities. Gross receipts and costs attributable to long-term contract activities means amounts included in total contract price or gross contract price, whichever is applicable, as determined under §1.460–4, and costs allocable to the contract, as determined under §1.460–5. Gross receipts and costs attributable to non-long-term contract activities (as defined in paragraph (d)(2) of this section) generally must be taken into account using permissible methods of accounting other than a long-term contract method. See section 446(c) and §1.446–1(c). However, if the performance of a non-long-term contract activity is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of one or more of the taxpayer's long-term contracts, the gross receipts and costs attributable to that activity must be allocated to the long-term contract(s) benefitted as provided in §§1.460–4(b)(4)(i) and 1.460–5(f)(2), respectively. Similarly, if a single long-term contract requires a taxpayer to perform a non-long-term contract activity that is not incident to or necessary for the manufacture, building, installation, or construction of the subject matter of the long-term contract, the gross receipts and costs attributable to that non-long-term contract activity must be separated from the contract and accounted for using a permissible method of accounting other than a long-term contract method. But see paragraph (g) of this section for related party rules.

(2) *Non-long-term contract activity. Non-long-term contract activity* means the performance of an activity other than manufacturing, building, installation, or construction, such as the provision of architectural, design, engineering, and construction management services; the performance under a guarantee, warranty, and maintenance agreement; and the development of software.

(e) *Severing and aggregating contracts*—(1) *In general.* After application of the allocation rules of paragraph (d) of this section, the severing and aggregating rules of this paragraph (e) may be applied by the Commissioner or the taxpayer as necessary to clearly reflect income (such as, to prevent the unreasonable deferral of recognition of income or the premature recognition of loss). Under the severing and aggregating rules, one agreement may be treated as two or more contracts, and two or more agreements may be treated as one contract. Except as provided in paragraph (e)(3)(ii) of this section, a taxpayer must determine whether to sever an agreement or to aggregate two or more agreements based on all the facts and circumstances known at the end of the contracting year.

(2) *Facts and circumstances.* Whether an agreement should be severed, or two or more agreements should be aggregated, depends on the following factors:

(i) *Independent pricing.* Independent pricing of items in an agreement is necessary for the agreement to be severed into two or more contracts. In the case of an agreement for several similar items, if the price to be paid for the items is determined under different terms or formulas (for example, if some items are priced under a cost-plus incentive fee arrangement and later items are to be priced under a fixed-price arrangement), then the difference in the pricing terms or formulas indicates that the items are independently priced.

(ii) *Interdependent pricing.* Interdependent pricing of items in separate agreements is necessary for two or more agreements to be aggregated into one contract. A single price negotiation for similar items ordered under one or more agreements indicates that the items are interdependently priced.

(iii) *Separate delivery or acceptance.* An agreement may not be severed into two or more contracts unless it provides for separate delivery or separate acceptance of items that are the subject matter of the agreement. However, the separate delivery or separate acceptance of items by itself does not necessarily require an agreement to be severed.

(iv) *Reasonable businessperson.* Two or more agreements to perform manufacturing or construction activities may not be aggregated into one contract unless a reasonable businessperson would not have entered into one of the agreements for the terms agreed upon without also entering into the other agreement(s). Similarly, an agreement to perform manufacturing or construction activities may not be severed into two or more contracts if a reasonable businessperson would not have entered into separate agreements containing terms allocable to each severed contract. For example, a single agreement to manufacture a prototype of an item, which would result in a substantial loss, and ten additional units of the item, which would result in a substantial gain, may not be severed into one contract for the prototype and another contract for the ten additional units under this paragraph (e)(2)(iv) because a reasonable businessperson would not have entered into a separate contract to manufacture the prototype. For purposes of this paragraph (e)(2)(iv), a taxpayer's expectation that the parties would enter into another agreement, when agreeing to the terms contained in the first agreement, is irrelevant.

(3) *Exceptions*—(i) *No severance for PCM.* A taxpayer may not sever under this paragraph (e) a long-term contract that would be accounted for using the PCM.

(ii) *Options and change orders.* Except as provided in paragraph (e)(3)(i) of this section, a taxpayer must sever an agreement that increases the number of units to be supplied to the customer, such as through the exercise of an option or the acceptance of a change order, if the agreement provides for separate delivery or separate acceptance of the additional units.

(4) *Statement with return.* If a taxpayer severs an agreement or aggregates two or more agreements under this paragraph (e) during the taxable year, the taxpayer must attach a statement to its original Federal income tax return for that year. This statement must contain the following information–

(i) The legend NOTIFICATION OF SEVERANCE OR AGGREGATION UNDER SEC. 1.460–1(e);

(ii) The taxpayer's name;

(iii) The taxpayer's employer identification number or social security number;

(iv) The identity of each agreement being severed or aggregated;

(v) The method of accounting used for each contract; and

(vi) A description of the reason(s) for severance or aggregation.

(f) *Classifying contracts*—(1) *In general.* A taxpayer must determine the classification of a contract (e.g., as a long-term manufacturing contract, long-term construction contract, non-long-term contract) based on all the facts and circumstances known no later than the end of the contracting year.

(2) *Hybrid contracts.* A long-term contract that requires a taxpayer to perform both manufacturing and construction activities (hybrid contract) generally must be classified as two contracts, a manufacturing contract and a construction contract. However, a hybrid contract may be classified as a manufacturing (or construction) contract if at least 95 percent of the estimated total allocable contract costs are reasonably allocable to the manufacturing (or construction) activities.

(3) *Method of accounting.* A taxpayer's method of classifying contracts is a method of accounting under section 446 and, thus, may not be changed without the Commissioner's consent. If a taxpayer's method of classifying contracts is unreasonable, that classification method is an impermissible accounting method.

(4) *Use of estimates*—(i) *Estimating length of contract.* A taxpayer must use a reasonable estimate of the time required to complete a contract when necessary to classify the contract (e.g., to determine whether the five-year completion rule for qualified ship contracts under §1.460–2(d), or the two-year completion rule for exempt construction contracts under §1.460–3(b), is satisfied; but, not to determine whether a contract is completed within the contracting year under paragraph (b)(1) of this section). To be considered reasonable, an estimate of the time required to complete the contract must include anticipated time for delay, rework, change orders, technology or design problems, or other problems that reasonably can be anticipated considering the nature of the contract and prior experience. A contract term that specifies an expected completion or delivery date may be considered evidence that the taxpayer reasonably expects to complete or deliver the subject matter of the contract on or about the date specified, especially if the contract provides bona fide penalties for failing to meet the specified date. If a taxpayer classifies a contract based on a reasonable estimate of completion time, the contract will not be reclassified based on the actual (or another reasonable estimate of) completion time. A taxpayer's estimate of completion time will not be considered unreasonable if a contract is not completed within the estimated time primarily because of unforeseeable factors not within the taxpayer's control, such as third-party litigation, extreme weather conditions, strikes, or delays in securing permits or licenses.

(ii) *Estimating allocable contract costs.* A taxpayer must use a reasonable estimate of total allocable contract costs when necessary to classify the contract (e.g., to determine whether a contract is a home construction contract under §1.460–(3)-(b)(2)). If a taxpayer classifies a contract based on a reasonable estimate of total allocable contract costs, the contract will not be reclassified based on the actual (or another reasonable estimate of) total allocable contract costs.

(g) *Special rules for activities benefitting long-term contracts of a related party*—(1) *Related party use of PCM*—(i) *In general.* Except as provided in paragraph (g)(1)(ii) of this section, if a related party and its customer enter into a long-term contract subject to the PCM, and a taxpayer performs any activity that is incident to or necessary for the related party's long-term contract, the taxpayer must account for the gross receipts and costs attributable to such activity using the PCM, even if this activity is not otherwise subject to section 460(a). This type of activity may include, for example, the performance of engineering and design services, and the production of components and subassemblies that are reasonably expected to be used in the production of the subject matter of the related party's contract.

(ii) *Inventory exception.* A taxpayer is not required to use the PCM under this paragraph (g) to account for components and subassemblies if the taxpayer regularly carries these items in its finished goods inventories and 80 percent or more of the gross receipts from the sale of these items typically comes from unrelated parties.

(2) *Total contract price.* If a taxpayer is required to use the PCM under paragraph (g)(1)(i) of this section, the total contract price (as defined in §1.460– 4(b)(4)(i)) is the fair market value of the taxpayer's activity that is incident to or necessary for the performance of the related party's long-term contract. The related party also must use the fair market value of the taxpayer's activity as the cost it incurs for the activity. The fair market value of the taxpayer's activity may or may not be the same as the amount the related party pays the taxpayer for that activity.

(3) *Completion factor.* To compute a contract's completion factor (as described in §1.460-4(b)(5)), the related party must take into account the fair market value of the taxpayer's activity that is incident to or necessary for the performance of the related party's long-term contract when the related party incurs the liability to the taxpayer for the activity, rather than when the taxpayer incurs the costs to perform the activity.

(h) *Effective date*—(1) *In general.* Except as otherwise provided, this section and §§1.460–2 through 1.460–5 are applicable for contracts entered into on or after the date these regulations are published as final regulations in the **Federal Register.**

(2) *Change in method of accounting.* Any change in a taxpayer's method of accounting necessary to comply with this section and §§1.460–2 through 1.460–5 is a change in method of accounting to which the provisions of section 446 and the regulations thereunder apply. For the first taxable year that includes the date these regulations are published as final regulations in the **Federal Register,** a taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with the provisions of this section and §§1.460–2 through 1.460–5 for long-term contracts entered into on or after the date this section and §§1.460–2 through 1.460–5 are published as final regulations in the **Federal Register.** A taxpayer that wants to change its method of accounting under this paragraph (h)(2) must follow the automatic consent procedures in Rev. Proc. 98–60 (1998–51 I.R.B. 16)(see §601.601(d)(2) of this chapter), except that the scope limitations in section 4.02 of Rev. Proc. 98–60 do not apply. Because a change under this paragraph (h)(2) is made on a cutoff basis, a section 481(a) adjustment is not required. Moreover, the taxpayer does not receive audit protection under section 7 of Rev. Proc. 98–60 in connection with a change under this paragraph (h)(2). A taxpayer that wants to change its exempt-

contract method of accounting is not granted the consent of the Commissioner under this paragraph (h)(2) and must file a Form 3115, Application for Change in Accounting Method, to obtain consent. See Rev. Proc. 97–27 (1997–1 C.B. 680)(see §601.601(d)(2) of this chapter).

(i) [Reserved]

(j) *Examples.* The following examples illustrate the rules of this section:

*Example 1. Contract for manufacture of property.* B notifies C, an aircraft manufacturer, that it wants to purchase an aircraft of a particular type. At the time C receives the order, C has on hand several partially completed aircraft of this type; however, C does not have any completed aircraft of this type on hand. C and B agree that B will purchase one of these aircraft after it has been completed. C retains title to and risk of loss with respect to the aircraft until the sale takes place. The agreement between C and B is a contract for the manufacture of property under paragraph (b)(2)(i) of this section, even if labeled as a contract for the sale of property, because the manufacture of the aircraft is necessary for C's obligations under the agreement to be fulfilled and the manufacturing was not complete when B and C entered into the agreement.

*Example 2. De minimis construction activity.* C, a master developer that uses a calendar taxable year, owns 5,000 acres of undeveloped land worth $50,000,000. To obtain permission from the local county government to improve this land, a service road must be constructed on this land to benefit all 5,000 acres. In 2001, C enters into a contract to sell a 1,000-acre parcel of undeveloped land to B, a residential developer, for its fair market value, $10,000,000. In this contract, C agrees to construct a service road running through the land that C is selling to B and through the 4,000 adjacent acres of undeveloped land that C has sold to several other residential developers for its fair market value, $40,000,000. C reasonably estimates that it will incur a liability of $50,000 to construct this service road, which will be owned and maintained by the county. C must reasonably allocate the cost of the service road among the benefitted parcels. The portion of the estimated total allocable contract costs that C allocates to the 1,000 acre parcel being sold to B (based upon its fair market value) is $10,000 ($50,000 × ($10,000,000/$50,000,000)). Construction of the service road is finished in 2002. Because the estimated total allocable contract costs attributable to C's construction activities, $10,000, are less than 10 percent of the contract's total contract price, $10,000,000, C's contract with B is not a construction contract under paragraph (b)(2)(ii) of this section. Thus, C's contract with B is not a long-term contract under paragraph (b)(2)(i) of this section, notwithstanding that construction of the service road is not completed in 2001.

*Example 3. Completion—customer use.* In 2002, C, a calendar year taxpayer, enters into a contract to construct a building for B. In November of 2003, the building is completed in every respect necessary for its intended use, and B occupies the building. In early December of 2003, B notifies C of some minor deficiencies that need to be corrected, and C agrees to correct them in January 2004. C reasonably estimates that the cost of correcting these deficiencies will be less than five percent of the total allocable contract costs. C's contract is complete under paragraph (c)(3)(i)(A) of this section in 2003 because in that year, B used the building and C had incurred at least 95 percent of the total allocable contract costs attributable to the building. C must use a permissible method of accounting for any deficiency-related costs incurred after 2003.

*Example 4. Completion—customer use.* In 1999, C, whose taxable year ends December 31, agrees to construct a shopping center, which includes an adjoining parking lot, for B. By October 2000, C has finished constructing the retail portion of the shopping center. By December 2000, C has graded the entire parking lot, but has paved only one-fourth of it because inclement weather conditions prevented C from laying asphalt on the remaining three-fourths. In December 2000, B opens the retail portion of the shopping center and the paved portion of the parking lot to the general public. C reasonably estimates that the cost of paving the remaining three-fourths of the parking lot when whether permits will exceed 5 percent of C's total allocable contract costs. Even though B is using the subject matter of the contract, C's contract is not completed in December 2000 under paragraph (c)(3)(i)(A) of this section because C has not incurred at least 95 percent of the total allocable contract costs attributable to the subject matter.

*Example 5. Non-long-term contract activity.* On January 1, 1999, C, whose taxable year ends December 31, enters into a single long-term contract to design and manufacture a satellite and to develop computer software enabling B to operate the satellite. At the end of 1999, C has not finished manufacturing the satellite. Designing the satellite and developing the computer software are non-long-term contract activities that are incident to and necessary for the taxpayer's manufacturing of the subject matter of a long-term contract because the satellite could not be manufactured without the design and would not operate without the software. Thus, under paragraph (d)(1) of this section, C must allocate these non-long-term contract activities to the long-term contract and account for the gross receipts and costs attributable to designing the satellite and developing computer software using the PCM.

*Example 6. Non-long-term contract activity.* C agrees to manufacture equipment for B under a long-term contract. In a separate contract, C agrees to design the equipment being manufactured for B under the long-term contract. Under paragraph (d)(1) of this section, C must allocate the gross receipts and costs related to the design to the long-term contract because designing the equipment is a non-long-term contract activity that is incident to and necessary for the manufacture of the subject matter of the long-term contract.

*Example 7. Severance.* On January 1, 1999, C, a construction contractor, and B, a real estate investor, enter into an agreement requiring C to build two office buildings in different areas of a large city. The agreement provides that the two office buildings will be completed by C and accepted by B in 1999 and 2000, respectively, and that C will be paid $1,000,000 and $1,500,000 for the two office buildings, respectively. The agreement will provide C with a reasonable profit from the construction of each building. Unless C is required to use the PCM to account for the contract, the taxpayer is required to sever this contract under paragraph (e)(2) of this section because the buildings are independently priced, the agreement provides for separate delivery and acceptance of the buildings, and, as each building will generate a reasonable profit, a reasonable businessperson would have entered into separate agreements for the terms agreed upon for each building.

*Example 8. Severance.* C, a large construction contractor with a calendar taxable year, accounts for its construction contracts using the PCM and has elected to use the 10-percent method described in §1.460–4(b)(6). In September 1999, C enters into an agreement to construct 4 buildings in 4 different cities. The buildings are independently priced and the contract provides a reasonable profit for each of the buildings. In addition, the agreement requires C to deliver one building per year in 2000, 2001, 2002, and 2003. As of December 31, 1999, C has incurred 25 percent of the estimated total allocable contract costs attributable to one of the buildings, but only 5 percent of the estimated total allocable contract costs attributable to all 4 buildings included in the agreement. Under paragraph (e)(3)(i) of this section, C may not sever this contract because it is accounted for using the PCM. Using the 10-percent method, C does not take into account any portion of the total contract price or any incurred allocable contract costs attributable to this agreement in 1999. Upon examination of C's 1999 tax return, the Commissioner determines that C entered into one agreement for 4 buildings rather than 4 separate agreements each for one building solely to take advantage of the deferral obtained under the 10-percent method. Consequently, in order to clearly reflect the taxpayer's income, the Commissioner may require C to sever the agreement into 4 separate contracts under paragraph (e)(2) of this section because the buildings are independently priced, the agreement provides for separate delivery and acceptance of the buildings, and a reasonable businessperson would have entered into separate agreements for these buildings.

*Example 9. Aggregation.* In 1999, C, a shipbuilder, enters into two agreements with the Department of the Navy as the result of a single negotiation. Each agreement obligates C to manufacture a submarine. Because the submarines are of the same class, their specifications are similar. Because C has never manufactured submarines of this class, however, C anticipates that it will incur substantially higher costs to manufacture the first submarine, to be delivered in 2005, than to manufacture the second submarine, to be delivered in 2008. If the agreements are treated as separate contracts, the first contract probably will produce a substantial loss, while the second contract probably will produce substantial profit. Based upon these facts, aggregation is required under paragraph (e)(2) of this section because the submarines are interdependently priced and a reasonable businessperson would not have entered the first agreement without also entering into the second.

*Example 10. Aggregation.* In 1999, C, a manufacturer of aircraft and related equipment, agrees to manufacture 10 military aircraft for foreign government B and to deliver the aircraft by the end of 2001. When entering into the agreement, C anticipates that it might receive production orders from B over the next 20 years for as many as 300 more of these aircraft. The negotiated contract price reflects C's and B's consideration of the expected total cost of manufacturing the 10 aircraft, the risks and opportunities associated with the agreement, and the additional factors the parties considered relevant. The negotiated price provides a profit on the sale of the 10 aircraft even if C does not expect to receive any additional production orders from B. It is unlikely, however, that C actually would have wanted to manufacture the 10 aircraft but for the expectation that it would receive additional production orders from B. In 2001, B accepts delivery of the 10 aircraft. At that time, B orders an additional 20 aircraft of the same type for delivery in 2005. When negotiating the price for the additional 20 aircraft, C and B consider the fact that the expected unit cost for this production run of 20 aircraft will be lower than the unit cost of the 10 aircraft completed and accepted in 2001, but substantially higher than the expected unit cost of future production runs. Based upon these facts, aggregation is not permitted under paragraph (e)(2) of this section. Because the parties negotiated the prices of both agreements considering only the expected production costs and risks for each agreement standing alone, the terms and conditions agreed upon for the first agreement are independent of the terms and conditions agreed upon for the second agreement. The fact that the agreement to manufacture 10 aircraft provides a profit for C indicates that a reasonable businessperson would have entered into that agreement without entering into the agreement to manufacture the additional 20 aircraft.

*Example 11. Classification and completion.* In 1999, C agrees to manufacture and install an industrial machine for B. The agreement requires C to deliver the machine in August 2001 and to install and test the machine in B's factory. At least 95 percent of the estimated total allocable contract costs are reasonably allocable to C's manufacturing activities. In addition, the agreement requires B to accept the machine when the tests prove that the machine's performance will satisfy the environmental standards set by the Environmental Protection Agency (EPA), even if B has not obtained the required operating permit. Because of technical difficulties, C cannot deliver the machine until December 2001, when B conditionally accepts delivery. C classifies the agreement as a manufacturing contract under paragraph (f) of this section because 95 percent of the total allocable contract costs are attributable to C's manufacturing activities. C, whose taxable year ends December 31, installs the machine in December 2001 and then tests it through February 2002. B accepts the machine in February 2002, but does not obtain the operating permit from the EPA until January 2003. Under paragraph (c)(3)(i)(B) of this section, C's contract is finally completed and accepted in February 2002, even though B does not obtain the operating permit until January 2003, because C completed all its obligations under the contract and B accepted the machine in 2002.

### *§1.460–2 Long-term manufacturing contracts.*

(a) *In general.* Section 460 generally requires a taxpayer to determine the income from a long-term manufacturing contract using the percentage-of-completion method described in §1.460–4(b) (PCM). A contract not completed in the contracting year is a long-term manufacturing contract if it involves the manufacture of personal property that is–

(1) A unique item of a type that is not normally carried in the finished goods inventory of the taxpayer; or

(2) An item that normally requires more than 12 calendar months to complete (regardless of the duration of the contract or the time to complete a deliverable quantity of the item).

(b) *Unique*—(1) *In general. Unique* means designed for the needs of a specific customer. A contract may require the taxpayer to manufacture more than one unit of a unique item. To determine whether an item is designed for the needs of a specific customer, a taxpayer must consider the extent to which research, development, design, engineering, retooling, and similar activities are required to produce the item. In addition, a taxpayer must consider whether the same item could be sold to other customers (with or without minor modifications).

(2) *Safe harbors.* Notwithstanding paragraph (b)(1) of this section, an item is not unique if it satisfies one or more of the following safe harbors—

(i) *Short production period.* An item is not unique if it normally requires 90 days or less to complete the item;

(ii) *Customized item.* An item is not unique if the total allocable contract costs attributable to customizing (such as research, development, design, engineering, retooling, and similar activities) that are incident to or necessary for the production of the item does not exceed 5 percent of the estimated total allocable contract costs allocable to the item; or

(iii) *Inventoried item.* A unique item ceases to be unique no later than when the taxpayer normally carries similar items in its finished goods inventory.

(c) *Normal time to complete*—(1) *In general.* The amount of time normally required to complete an item is the item's reasonably expected *production period*, as described in §1.263A–12, determined at the end of the contracting year. Thus, the expected production period for an item generally would begin when a taxpayer incurs at least five percent of the costs allocable to the item and end when the item is ready to be held for sale and all reasonably expected production activities are complete. In the case of components that are assembled or reassembled into an item or unit at the customer's facility by the taxpayer's employees or agents, the production period ends when the components are assembled or reassembled into an operable item or unit. To the extent that several distinct activities related to the production of the item are expected to occur simultaneously, the period during which these distinct activities occur is not counted more than once.

(2) *Production by related parties.* To determine the time normally required to complete an item, a taxpayer must consider all relevant production activities performed by itself and by related parties, as defined in §1.460–1(b)(4). For example, if a taxpayer's item requires a component or subassembly manufactured by a related party, the taxpayer must consider the time the related party takes to complete the component or subassembly and, for purposes of determining the beginning of an item's production period, the costs incurred by the related party that are allocable to the component or subassembly. However, if both requirements of the inventory exception under §1.460–1(g)(1)(ii) are satisfied, a taxpayer does not consider the activities performed or the costs incurred by a related party when determining the normal time to complete an item.

(d) *Qualified ship contracts.* A taxpayer may determine the income from a long-term manufacturing contract that is a qualified ship contract using either the PCM or the percentage-of-completion/capitalized-cost method (PCCM) of accounting described in §1.460–4(e). A *qualified ship contract* is any contract entered into after February 28, 1986, to manufacture in the United States not more than 5 seagoing vessels if the vessels will not be manufactured directly or indirectly for the United States Government and if the taxpayer reasonably expects to complete the contract within 5 years of the contract commencement date. Under §1.460–1(e)(3)(i), a contract to produce more than 5 vessels for which the PCM would be required cannot be severed in order to be classified as a qualified ship contract.

(e) *Examples.* The following examples illustrate the rules of this section:

*Example 1. Unique item and classification.* In December 1999, C enters into a contract with B to design and manufacture a new type of industrial equipment. C reasonably expects the normal production period for this type of equipment to be 8 months. Because the new type of industrial equipment requires a substantial amount of research, design and engineering to produce, C determines that the equipment is a unique item and its contract with B is a long-term contract. After delivering the equipment to B in September 2000, C contracts with B to produce five additional units of industrial equipment using the same basic design as the previous unit of industrial equipment but changing certain specifications. These additional units, which also are expected to take 8 months to produce, will be delivered to B in 2001. C determines that the research, design, engineering, retooling and similar customizing costs necessary to produce the five additional units of equipment does not exceed 5% of the estimated total allocable contract costs. Consequently, the additional units of equipment satisfy the safe harbor in paragraph (b)(2)(ii) of this section and are not unique items. Although C's contract with B to produce the five additional units is not completed within the contracting year, the contract is not a long-term contract since the additional units of equipment are not unique items and do not normally require more than 12 months to produce. C must classify its second contract with B as a non-long term contract, notwithstanding that it classified the previous contract with B for a similar item as a long-term contract, because the determination of whether a contract is a long-term contract is made on a contract by contract basis. Such a change in classification is not a change in method of accounting because the change in classification results from a change in underlying facts.

*Example 2. 12-month rule—related party.* C manufactures cranes that it regularly carries in finished goods inventory. C purchases one of the crane's components from R, a related party under §1.460–1(b)(4). R does not carry this crane component in finished goods inventory; therefore, C does not satisfy the inventory exception and must consider the activities of R as R incurs costs and performs the activities rather than as C incurs a liability to R. The normal time period between the time that both C and R incur 5% of the costs allocable to the crane and the time that R completes the component is 5 months. C normally requires an additional 8 months to complete production of the crane after receiving the integral component from R. C's crane is an item of a type that normally requires more than 12 months to complete under paragraph (c) of this section because the production period from the time that both C and R incur 5% of the costs allocable to the crane until the time that production of the crane is complete is normally 13 months.

*Example 3. 12-month rule—duration of contract.* The facts are the same as in *Example 2,* except that C enters into a sales contract with B on December 31, 1999 (the last day of C's taxable year), and delivers a completed crane to B on February 1, 2000. C's contract with B is a long-term contract under paragraph (a)(2) of this section because the contract is not completed in the contracting year, 1999, and the crane is an item that normally requires more than 12 calendar months to complete (regardless of the duration of the contract).

*Example 4. 12-month rule—normal time to complete.* The facts are the same as in *Example 3,* except that C (and R) actually complete B's crane in only 10 calendar months. The contract is a long-term contract because the normal time to complete a crane, not the actual time to complete a crane, is the relevant criterion for determining whether an item is subject to paragraph (a)(2) of this section.

*§1.460–3 Long-term construction contracts.*

(a) *In general.* Section 460 generally requires a taxpayer to determine the income from a long-term construction contract using the percentage-of-completion method described in §1.460–4(b) (PCM). A contract not completed in the contracting year is a long-term construction contract if it involves the building, construction, reconstruction, or rehabilitation of real property; the installation of an integral component to real property; or the improvement of real property (collectively referred to as construction). *Real property* means land, buildings, and *inherently permanent structures,* as defined in §1.263A–8(c)(3), such as roadways, dams, and bridges. Real property does not include vessels, offshore drilling platforms, or unsevered natural products of land. An *integral component to real property* includes property not produced at the site of the real property but intended to be permanently affixed to the real property, such as elevators and central heating and cooling systems. Thus, for example, a contract to install an elevator in a building is a construction contract because a building is real property, but a contract to install an elevator in a ship is not a construction contract because a ship is not real property.

(b) *Exempt construction contracts*—(1) *In general*. The general requirement to use the PCM and the cost allocation rules described in §1.460–5(b) or (c) does not apply to any long-term construction contract described in this paragraph (b) (exempt construction contract). *Exempt construction contract* means any–

(i) Home construction contract; and

(ii) Other construction contract that a taxpayer estimates (when entering into the contract) will be completed within 2 years of the contract commencement date, provided the taxpayer satisfies the $10,000,000 gross receipts test described in paragraph (b)(3) of this section.

(2) *Home construction contract*—(i) *In general.* A long-term construction contract is a *home construction contract* if a taxpayer (including a subcontractor working for a general contractor) reasonably expects to attribute 80 percent or more of the estimated total allocable contract costs (including the cost of land, materials, and services), determined as of the close of the contracting year, to the construction of—

(A) Dwelling units, as defined in section 168(e)(2)(A)(ii)(I), contained in buildings containing 4 or fewer dwelling units (including buildings with 4 or fewer dwelling units that also have commercial units); and

(B) Improvements to real property directly related to, and located at the site of, the dwelling units.

(ii) *Townhouses and rowhouses.* Each townhouse or rowhouse is a separate building.

(iii) *Common improvements*. A taxpayer includes in the cost of the dwelling units their allocable share of the cost that the taxpayer reasonably expects to incur for any common improvements (e.g., sewers, roads, clubhouses) that benefit the dwelling units and that the taxpayer is contractually obligated, or required by law, to construct within the tract or tracts of land that contain the dwelling units.

(iv) *Mixed use costs.* If a contract involves the construction of both commercial units and dwelling units within the same building, a taxpayer must allocate the costs among the commercial units and dwelling units using a reasonable method or combination of reasonable methods, such as specific identification, square footage, or fair market value.

(3) *$10,000,000 gross receipts test*—(i) *In general*. The $10,000,000 gross receipts test is satisfied if a taxpayer's (or predecessor's) average annual gross receipts for the 3 taxable years preceding the contracting year do not exceed $10,000,000, as determined using the principles of the gross receipts test for small resellers under §1.263A–3(b), except as otherwise provided in paragraphs (b)(3)(ii) and (iii) of this section.

(ii) *Single employer.* To apply the gross receipts test, a taxpayer is not required to aggregate the gross receipts of persons treated as a single employer solely under section 414(m) and any regulations prescribed under section 414.

(iii) *Attribution of gross receipts.* A taxpayer must aggregate a proportionate share of the construction-related gross receipts of any person that has a five percent or greater interest in the taxpayer. In addition, a taxpayer must aggregate a proportionate share of the construction-related gross receipts of any person in which the taxpayer has a five percent or greater interest. For this purpose, a taxpayer must determine ownership interests as of the first day of the taxpayer's contracting year and must include indirect interests in any corporation, partnership, estate, trust, or sole proprietorship according to principles similar to the constructive ownership rules under sections 1563(e), (f)(2), and (f)(3)(A). However, a taxpayer is not required to aggregate under this paragraph (b)(3)(iii) any construction-related gross receipts required to be aggregated under paragraph (b)(3)(i) of this section.

(c) *Residential construction contracts.* A taxpayer may determine the income from a long-term construction contract that is a residential construction contract using either the PCM or the percentage-of-completion/capitalized-cost method (PCCM) of accounting described in §1.460–4(e). A *residential construction contract* is a home construction contract, as defined in paragraph (b)(2) of this section, except that the building or buildings being constructed contain more than 4 dwelling units.

Par. 7. Section 1.460–4 is amended by adding paragraphs (a) through (i) to read as follows:

*§1.460– Methods of accounting for long-term contracts.*

(a) *Overview.* This section prescribes permissible methods of accounting for long-term contracts. Paragraph (b) of this section describes the percentage-of-completion method under section 460(b) (PCM) that a taxpayer generally must use to determine the income from a long-term contract. Paragraph (c) of this section lists permissible methods of accounting for exempt construction contracts described in §1.460–3(b)(1) and describes the exempt-contract percentage-of-completion method (EPCM). Paragraph (d) of this section describes the completed-contract method (CCM), which is one of the permissible methods of accounting for exempt construction contracts. Paragraph (e) describes the percentage-of-completion/capitalized-cost method (PCCM), which is a permissible method of accounting for qualified ship contracts described in §1.460–2(d) and residential construction contracts described in §1.460–3(c). Paragraph (f) of this section provides rules for determining the alternative minimum taxable income (AMTI) from long-term contracts that are not exempted under section 56. Paragraph (g) of this section provides rules concerning consistency in methods of accounting for long-term contracts. Paragraph (h) of this section provides examples illustrating the principles of this section. Finally, paragraph (j) of this section provides rules for taxpayers that file consolidated tax returns.

(b) *Percentage-of-completion method*—(1) *In general.* Under the PCM, a taxpayer generally must include in income the portion of the *total contract price,* as defined in paragraph (b)(4)(i) of this section, that corresponds to the percentage of the entire contract that the taxpayer has completed during the taxable year. The percentage of completion must be determined by comparing allocable contract costs incurred with estimated total allocable contract costs. Thus, the taxpayer includes a portion of the total contract price in gross income as the taxpayer incurs allocable contract costs.

(2) *Computations.* To determine the income from a long-term contract, a taxpayer—

(i) Computes the *completion factor* for the contract, which is the ratio of the cumulative allocable contract costs that the taxpayer has incurred through the end of the taxable year to the estimated total allocable contract costs that the taxpayer reasonably expects to incur under the contract;

(ii) Computes the amount of *cumulative gross receipts* from the contract by multiplying the completion factor by the total contract price;

(iii) Computes the amount of *current-year gross receipts,* which is the difference between the amount of cumulative gross receipts for the current taxable year and the amount of cumulative gross receipts for the immediately preceding taxable year (the difference can be a positive or negative number); and

(iv) Takes both the current-year gross receipts and the allocable contract costs incurred during the current year into account in computing taxable income.

(3) *Post-completion-year income.* If a taxpayer has not included the total contract price in gross income by the completion year, as defined in §1.460-1(b)(6), the taxpayer must include the remaining portion of the total contract price in gross income for the taxable year following the completion year. For the treatment of post-completion costs, see paragraph (b)(5)(v) of this section. See §1.460–6(c)(1)(ii) for application of the look-back method as a result of adjustments to total contract price.

(4) *Total contract price*—(i) *In general*—(A) *Definition.* Total contract price means the amount that a taxpayer reasonably expects to receive under a long-term contract, including holdbacks, retainages, and cost reimbursements. See §1.460–6(c)(1)(ii) and (2)(vi) for application of the look-back method as a result of changes in total contract price.

(B) *Contingent compensation.* Any amounts related to contingent rights or obligations, such as bonuses, awards, incentive payments, and amounts in dispute, are included in total contract price as soon as it is reasonably estimated that they will be received, even if the all events test has not yet been met. For example, if a bonus is payable to a taxpayer for meeting an early completion date, the bonus is includible in total contract price at the time (and to the extent) that the taxpayer can predict the achievement of the corresponding objective with reasonable certainty. Similarly, a portion of the contract price that is in dispute is included in total contract price at the time and to the extent that the taxpayer can reasonably expect the dispute will be resolved in the taxpayer's favor (without regard to when the taxpayer receives payment for the amount in dispute or when the dispute is finally resolved.) If a taxpayer has not included an amount of contingent compensation in total contract price under this paragraph (b)(4)(i) by the taxable year following the completion year, the taxpayer must account for that amount of contingent compensation using a permissible method of accounting. If it is determined after the taxable year following the completion year that an amount included in total contract price will not be earned, the taxpayer should deduct that amount in the year of the determination.

(C) *Non-long-term contract activities.* Total contract price includes an allocable share of the gross receipts attributable to a non-long-term contract activity, as defined in §1.460–1(d)(2), if the activity is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of the long-term contract. Total contract price also includes amounts reimbursed for independent research and development costs, or bidding and proposal costs, under a federal or cost- plus long-term contract (as defined in section 460(d)), regardless of whether the research and development, or bidding and proposal, activities are incident to or necessary for the performance of that long-term contract.

(ii) *Estimating total contract price.* A taxpayer must estimate the total contract price based upon all the facts and circumstances known as of the last day of the taxable year. For this purpose, an event that occurs after the end of the taxable year must be taken into account if its occurrence was reasonably foreseeable and its income was subject to reasonable estimation as of the last day of that taxable year.

(5) *Completion factor*—(i) *Allocable contract costs.* A taxpayer must use a cost allocation method permitted under either §1.460–5(b) or (c) to determine the amount of cumulative allocable contract costs and estimated total allocable contract costs that are used to determine a contract's completion factor. Allocable contract costs include a reimbursable cost that is allocable to the contract.

(ii) *Cumulative allocable contract costs incurred.* To determine a contract's completion factor for a taxable year, a taxpayer must take into account the cumulative allocable contract costs that have been incurred, as defined in §1.460–1(b)(8), through the end of the taxable year.

(iii) *Estimating total allocable contract costs.* A taxpayer must estimate total allocable contract costs for each long-term contract based upon all the facts and circumstances known as of the last day of the taxable year. For this purpose, an event that occurs after the end of the taxable year must be taken into account if its occurrence was reasonably foreseeable and its cost was subject to reasonable estimation as of the last day of that taxable year. To be considered reasonable, an estimate of total allocable contract costs must include costs attributable to delay, rework, change orders, technology or design problems, or other problems that reasonably can be anticipated considering the nature of the contract and prior experience. However, estimated total allocable contract costs do not include any contingency allowance for costs that, as of the end of the taxable year, are not reasonably expected to be incurred in the performance of the contract. For example, estimated total allocable contract costs do not include any costs attributable to factors not reasonably foreseeable at the end of the taxable year, such as third-party litigation, extreme weather conditions, strikes, and delays in securing required permits and licenses. In addition, the estimated costs of performing other agreements that are not aggregated with the contract under §1.460–1(e) that the taxpayer expects to incur with the same customer (e.g., follow-on contracts) are not included in estimated total allocable contract costs for the initial contract.

(iv) *Pre-contracting-year costs.* If a taxpayer reasonably expects to enter into a long-term contract in a future taxable year, the taxpayer must capitalize all costs incurred prior to entering into the contract that will be allocable to that contract (e.g., bidding and proposal costs). A taxpayer is not required to compute a completion factor, or to include in gross income any amount, related to allocable contract costs for any taxable year ending before the contracting year or, if applicable, the 10-percent year defined in paragraph (b)(6)(i) of this section. In that year, the taxpayer is required to compute a completion factor that includes all allocable contract costs that have been incurred as of the end of that taxable year (whether previously capitalized or deducted) and to take into account in computing taxable income the related gross receipts and the previously capitalized allocable contract costs.

(v) *Post-completion-year costs.* If a taxpayer incurs an allocable contract cost after the completion year, the taxpayer must account for that cost using a permissible method of accounting. See §1.460–6(c)(1)(ii) for application of the look-back method as a result of adjustments to allocable contract costs.

(6) *10-percent method*—(i) *In general.* Instead of determining the income from a long-term contract beginning with the contracting year, a taxpayer may elect to use the 10-percent method under section 460(b)(5). Under the 10-percent method, a taxpayer does not include in gross income any amount related to allocable contract costs until the taxable year in which the taxpayer has incurred at least 10 percent of the estimated total allocable contract costs (10-percent year). A taxpayer must treat costs incurred before the 10-percent year as pre- contracting-year costs described in paragraph (b)(5)(iv) of this section.

(ii) *Election.* A taxpayer makes an election under this paragraph (b)(6) by using the 10-percent method for all long-term contracts entered into during the taxable year of the election on its original federal income tax return for the election year. This election is a method of accounting and, thus, applies to all long-term contracts entered into during and after the taxable year of the election. An electing taxpayer must use the 10-percent method to apply the look-back method under §1.460–6 and to determine alternative minimum taxable income under paragraph (f) of this section. This election is not available if a taxpayer uses the simplified cost-to-cost method described in §1.460–5(c) to compute the completion factor of a long-term contract.

(c) *Exempt contract methods*—(1) *In general.* An exempt contract method means the method of accounting that a taxpayer must use to account for all its long-term contracts (and any portion of a long-term contract) that are exempt from the requirements of section 460(a). Thus, an exempt contract method applies to exempt construction contracts, as defined in §1.460–3(b); the non-PCM portion of a qualified ship contract, as defined in §1.460–2(d); and the non-PCM portion of a residential construction contract, as defined in §1.460–3(c). Permissible exempt contract methods include the PCM, the EPCM described in paragraph (c)(2) of this section, the CCM described in paragraph (d) of this section, or any other permissible method. See section 446.

(2) *Exempt-contract percentage-of-completion method*—(i) *In general.* Similar to the PCM described in paragraph (b) of this section, a taxpayer using the

EPCM generally must include in income the portion of the total contract price, as described in paragraph (b)(4) of this section, that corresponds to the percentage of the entire contract that the taxpayer has completed during the taxable year. However, under the EPCM, the percentage of completion may be determined as of the end of the taxable year by using any method of cost comparison (such as comparing direct labor costs incurred to date to estimated total direct labor costs) or by comparing the work performed on the contract with the estimated total work to be performed, rather than by using the cost-to-cost comparison required by paragraphs (b)(2)(i) and (5) of this section, provided such method is used consistently and clearly reflects income. In addition, paragraph (b)(3) of this section (regarding post-completion-year income), paragraph (b)(6) of this section (regarding the 10-percent method) and §1.460–6 (regarding the look-back method) do not apply to the EPCM.

(ii) *Determination of work performed.* For purposes of the EPCM, the criteria used to compare the work performed on a contract as of the end of the taxable year with the estimated total work to be performed must clearly reflect the earning of income with respect to the contract. For example, in the case of a roadbuilder, a standard of completion solely based on miles of roadway completed in a case where the terrain is substantially different may not clearly reflect the earning of income with respect to the contract.

(d) *Completed-contract method*—(1) *In general.* Except as otherwise provided in paragraph (d)(4) of this section, a taxpayer using the CCM to account for a long-term contract must take into account in the contract's completion year, as defined in §1.460–1(b)(6), the gross contract price and all allocable contract costs incurred by the completion year. A taxpayer may not treat the cost of any materials and supplies that were allocated to a contract, but actually remain on hand when the contract is completed, as an allocable contract cost.

(2) *Post-completion-year income and costs.* If a taxpayer has not included an item of contingent compensation (i.e. amounts for which the all events test has not been satisfied) in gross contract price under paragraph (d)(3) of this section by the completion year, the taxpayer must account for this item of contingent compensation using a permissible method of accounting. If a taxpayer incurs an allocable contract cost after the completion year, the taxpayer must account for that cost using a permissible method of accounting.

(3) *Gross contract price.* Gross contract price includes all amounts (including holdbacks, retainages, and reimbursements) that a taxpayer is entitled by law or contract to receive, whether or not the amounts are due or have been paid. In addition, gross contract price includes all bonuses, awards, and incentive payments, such as a bonus for meeting an early completion date, to the extent the all events test is satisfied. If a taxpayer performs a non-long-term contract activity, as defined in §1.460–1(d)(2), that is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of one or more of the taxpayer's long-term contracts, the taxpayer must include an allocable share of the gross receipts attributable to that activity in the gross contract price of the contract(s) benefitted by that activity. Gross contract price also includes amounts reimbursed for independent research and development costs, or bidding and proposal costs, under a federal or cost-plus long-term contract (as defined in section 460(d)), regardless of whether the research and development, or bidding and proposal, activities are incident to or necessary for the performance of that long-term contract.

(4) *Contracts with disputed claims*—(i) *In general.* The special rules in this paragraph (d)(4) apply to a long-term contract accounted for using the CCM with a dispute caused by a customer requesting a reduction of the gross contract price or the performance of additional work under the contract or by a taxpayer requesting an increase in gross contract price, or both, on or after the date a taxpayer has tendered the subject matter of the contract to the customer.

(ii) *Taxpayer assured of profit or loss.* If the disputed amount relates to a customer's claim for either a reduction in price or additional work and the taxpayer is assured of either a profit or a loss on a long-term contract regardless of the outcome of the dispute, the gross contract price, reduced (but not below zero) by the amount reasonably in dispute, must be taken into account in the completion year. If the disputed amount relates to a taxpayer's claim for an increase in price and the taxpayer is assured of either a profit or a loss on a long-term contract regardless of the outcome of the dispute, the gross contract price must be taken into account in the completion year. If the taxpayer is assured a profit on the contract, all allocable contract costs incurred by the end of the completion year are taken into account in that year. If the taxpayer is assured a loss on the contract, all allocable contract costs incurred by the end of the completion year, reduced by the amount reasonably in dispute, are taken into account in the completion year.

(iii) *Taxpayer unable to determine profit or loss.* If the amount reasonably in dispute affects so much of the gross contract price or allocable contract costs that a taxpayer cannot determine whether a profit or loss ultimately will be realized from a long-term contract, the taxpayer may not take any of the gross contract price or allocable contract costs into account in the completion year.

(iv) *Dispute resolved.* Any part of the gross contract price and any allocable contract costs that have not been taken into account because of the principles described in paragraph (d)(4)(i), (ii) or (iii) of this section must be taken into account in the taxable year in which the dispute is resolved. If a taxpayer performs additional work under the contract because of the dispute, the term *taxable year in which the dispute is resolved* means the taxable year the additional work is completed, rather than the taxable year in which the outcome of the dispute is determined by agreement, decision, or otherwise.

(e) *Percentage-of-completion/capitalized-cost method.* Under the PCCM, a taxpayer must determine the income from a long-term contract using the PCM for the applicable percentage of the contract and its exempt contract method, as defined in paragraph (c) of this section, for the remaining percentage of the contract. For residential construction contracts described in §1.460–3(c), the applicable percentage is 70 percent, and the remaining percentage is 30 percent. For qualified ship contracts described in §1.460–

2(d), the applicable percentage is 40 percent, and the remaining percentage is 60 percent.

(f) *Alternative minimum taxable income*—(1) *In general*. Under section 56(a)(3), a taxpayer (not exempt from the AMT under section 55(e)) must use the PCM to determine its AMTI from any long-term contract entered into on or after March 1, 1986, that is not a home construction contract, as defined in §1.460–3(b)(2). For AMTI purposes, the PCM must include any election under paragraph (b)(6) of this section (concerning the 10-percent method) or under §1.460– 5(c) (concerning the simplified cost-to-cost method) that the taxpayer has made for regular tax purposes. For exempt construction contracts described in §1.460–3(b)(1)(ii), a taxpayer must use the simplified cost-to-cost method to determine the completion factor for AMTI purposes. Except as provided in paragraph (f)(2) of this section, a taxpayer must use AMTI costs and AMTI methods, such as the depreciation method described in section 56(a)(1), to determine the completion factor of a long-term contract (except a home construction contract) for AMTI purposes.

(2) *Election to use regular completion factors*. Under this paragraph (f)(2), a taxpayer may elect for AMTI purposes to determine the completion factors of all of its long-term contracts using the methods of accounting and allocable contract costs used for regular federal income tax purposes. A taxpayer makes this election by using regular methods and regular costs to compute the completion factors of all long-term contracts entered into during the taxable year of the election for AMTI purposes on its original federal income tax return for the election year. This election is a method of accounting and, thus, applies to all long-term contracts entered into during and after the taxable year of the election. Although a taxpayer may elect to compute the completion factor of its long-term contracts using regular methods and regular costs, an election under this paragraph (f)(2) does not eliminate a taxpayer's obligation to comply with the requirements of section 55 when computing AMTI. For example, although a taxpayer may elect to use the depreciation methods used for regular tax purposes to compute the completion factor of its long-term contracts for AMTI purposes, the taxpayer must use the depreciation methods permitted by section 56 to compute AMTI.

(g) *Method of accounting*. A taxpayer that uses the PCM, EPCM, CCM, PCCM, or elects the 10-percent method or special AMTI method (or changes to another method of accounting with the Commissioner's consent) must apply the method(s) consistently for all similarly classified long-term contracts, until the taxpayer obtains the Commissioner's consent under section 446(e) to change to another method of accounting.

(h) *Examples*. The following examples illustrate the rules of this section:

*Example 1. PCM—estimating total contract price*. On January 1, 1999, C, who uses a calendar taxable year, enters into a contract to design and manufacture a satellite (a unique item). The contract provides that C will be paid $10,000,000 for delivering the completed satellite by December 1, 2000. The contract also provides that C will receive a $3,000,000 bonus for delivering the satellite by July 1, 2000, and an additional $4,000,000 bonus if the satellite successfully performs its mission for five years. C is unable to reasonably predict if the satellite will successfully perform its mission for five years. If on December 31, 1999, C should reasonably expect to deliver the satellite by July 1, 2000, the estimated total contract price is $13,000,000 ($10,000,000 unit price + $3,000,000 production-related bonus). Otherwise, the estimated total contract price is $10,000,000. In either event, the $4,000,000 bonus is not includible in the estimated total contract price as of December 31, 1999, because C is unable to reasonably predict that the satellite will successfully perform its mission for five years.

*Example 2. PCM—computing income*. (i) C, who uses a calendar taxable year, determines the income from long-term contracts using the PCM. During 1999, C agrees to manufacture for the customer, B, a unique item for a total contract price of $1,000,000. Under C's contract, B is entitled to retain 10 percent of the total contract price until it accepts the item. By the end of 1999, C has incurred $200,000 of allocable contract costs and estimates that the total allocable contract costs will be $800,000. By the end of 2000, C has incurred $600,000 of allocable contract costs and estimates that the total allocable contract costs will be $900,000. In 2001, after completing the contract, C determines that the actual cost to manufacture the item was $750,000.

(ii) For each of the taxable years, C's income from the contract is computed as follows:

| | Taxable Year | | |
|---|---|---|---|
| | 1999 | 2000 | 2001 |
| (A) Cumulative incurred costs | $ 200,000 | $ 600,000 | $ 750,000 |
| (B) Estimated total costs | 800,000 | 900,000 | 750,000 |
| (C) Completion factor: (A) ÷ (B) | 25.00% | 66.67% | 100.00% |
| (D) Total contract price | 1,000,000 | 1,000,000 | 1,000,000 |
| (E) Cumulative gross receipts: (C) × (D) | 250,000 | 666,667 | 1,000,000 |
| (F) Cumulative gross receipts: (prior year) | ( 0) | ( 250,000) | ( 666,667) |
| (G) Current-year gross receipts | 250,000 | 416,667 | 333,333 |
| (H) Cumulative incurred costs | 200,000 | 600,000 | 750,000 |
| (I) Cumulative incurred costs: (prior year) | ( 0) | ( 200,000) | ( 600,000) |
| (J) Current-year costs | 200,000 | 400,000 | 150,000 |
| (K) Gross income (G) – (J) | $ 50,000 | $ 16,667 | $ 183,333 |

*Example 3. PCM—computing income with cost sharing.* (i) C, who uses a calendar taxable year, determines the income from long-term contracts using the PCM. During 1999, C enters into a contract to manufacture a unique item. The contract specifies a target price of $1,000,000, a target cost of $600,000, and a target profit of $400,000. C and B will share the savings of any cost under run (actual total incurred cost is less than target cost) and the additional cost of any cost overrun (actual total incurred cost is greater than target cost) as follows: 30 percent to C and 70 percent to B. By the end of 1999, C has incurred $200,000 of allocable contract costs and estimates that the total allocable contract costs will be $600,000. By the end of 2000, C has incurred $300,000 of allocable contract costs and estimates that the total allocable contract costs will be $400,000. In 2001, after completing the contract, C determines that the actual cost to manufacture the item was $700,000.

(ii) For each of the taxable years, C's income from the contract is computed as follows (Note that the sharing of any cost under run or cost overrun is reflected as an adjustment to C's target price under paragraph (b)(4)(i) of this section):

| | Taxable Year | | |
|---|---|---|---|
| | 1999 | 2000 | 2001 |
| (A) Cumulative incurred costs | $ 200,000 | $ 300,000 | $ 700,000 |
| (B) Estimated total costs | 600,000 | 400,000 | 700,000 |
| (C) Completion factor: (A) ÷ (B) | 33.33% | 75.00% | 100.00% |
| (D) Target price | $1,000,000 | $1,000,000 | $1,000,000 |
| (E) Estimated total costs | 600,000 | 400,000 | 700,000 |
| (F) Target costs | 600,000 | 600,000 | 600,000 |
| (G) Cost (under run)/overrun: (E) – (F) | 0 | (200,000) | 100,000 |
| (H) Adjustment rate | 70% | 70% | 70% |
| (I) Target price adjustment | 0 | (140,000) | 70,000 |
| (J) Total contract price: (D) + (I) | $1,000,000 | $ 860,000 | $1,070,000 |
| (K) Cumulative gross receipts: (C) × (J) | $ 333,333 | $ 645,000 | $1,070,000 |
| (L) Cumulative gross receipts: (prior year) | ( 0) | (333,333) | (645,000) |
| (M) Current-year gross receipts | 333,333 | 311,667 | 425,000 |
| (N) Cumulative incurred costs | 200,000 | 300,000 | 700,000 |
| (O) Cumulative incurred costs: (prior year) | ( 0) | (200,000) | (300,000) |
| (P) Current-year costs | 200,000 | 100,000 | 400,000 |
| (Q) Gross income: (M) – (P) | $ 133,333 | $ 211,667 | $ 25,000 |

*Example 4. PCM—10 percent method.* (i) In November 1999, C, who determines income using the PCM and who uses a calendar taxable year, agrees to manufacture a unique item for $1,000,000. C reasonably estimates that the total allocable contract costs will be $600,000. By December 31, 1999, C has received $50,000 in progress payments and incurred $40,000 of costs. C elects to use the 10 percent method effective for 1999 and all subsequent taxable years. During 2000, C receives $500,000 in progress payments and incurs $260,000 of costs. In 2001, C incurs an additional $300,000 of costs, C finishes manufacturing the item, and receives the final $450,000 payment.

(ii) For each of the taxable years, C's income from the contract is computed as follows:

| | Taxable Year | | |
|---|---|---|---|
| | 1999 | 2000 | 2001 |
| (A) Cumulative incurred costs | $ 40,000 | $ 300,000 | $ 600,000 |
| (B) Estimated total costs | 600,000 | 600,000 | 600,000 |
| (C) Completion factor (A) ÷ (B) | 6.67% | 50.00% | 100.00% |
| (D) Total contract price | 1,000,000 | 1,000,000 | 1,000,000 |
| (E) Cumulative gross receipts: (C) × (D)* | 0 | 500,000 | 1,000,000 |
| (F) Cumulative gross receipts: (prior year) | ( 0) | ( 0) | ( 500,000) |
| (G) Current-year gross receipts | 0 | 500,000 | 500,000 |
| (H) Cumulative incurred costs | 0 | 300,000 | 600,000 |
| (I) Cumulative incurred costs: (prior year) | ( 0) | ( 0) | ( 300,000) |
| (J) Current-year costs | 0 | 300,000 | 300,000 |
| (K) Gross income: (G) – (J) | $ 0 | $ 200,000 | $ 200,000 |

* Unless (C) < 10 percent.

*Example 5. CCM–contracts with disputes from customer claims.* In 2001, C, who uses the CCM to account for exempt construction contracts and uses a calendar taxable year, enters into a contract to construct a bridge for B. The terms of the contract provide for a $1,000,000 gross contract price. C finishes the bridge in 2002 at a cost of $950,000. When B examines the bridge, B insists that C either repaint several girders or reduce the contract price. The amount reasonably in dispute is $10,000. In 2003, C and B resolve their dispute, C repaints the girders at a cost of $6,000, and C and B agree that the contract price is not to be reduced. Because C is assured a profit of $40,000 ($1,000,000 – $10,000 - $950,000) in 2002 even if the dispute is resolved in B's favor, C must take this $40,000 into account in 2002. In 2003, C will earn an additional $4,000 profit ($1,000,000 – $956,000 – $40,000) from the contract with B. Thus, C must take into account an additional $10,000 of gross contract price and $6,000 of additional contract costs in 2003.

*Example 6. CCM–contracts with disputes from taxpayer claims.* In 2003, C, who uses the CCM to account for exempt construction contracts and uses a calendar taxable year, enters into a contract to construct a building for B. The terms of the contract provide for a $1,000,000 gross contract price. C finishes the building in 2004 at a cost of $1,005,000. B examines the building in 2004 and agrees that it meets the contract's specifications; however, at the end of 2004, C and B are unable to agree on the merits of C's claim for an additional $10,000 for items that C alleges are changes in contract specifications and B alleges are within the scope of the contract's original specifications. In 2005, B agrees to pay C an additional $2,000 to satisfy C's claims under the contract. Because the amount in dispute affects so much of the gross contract price that C cannot determine in 2004 whether a profit or loss will ultimately be realized, C may not taken any of the gross contract price or allocable contract costs into account in 2004. C must take into account $1,002,000 of gross contract price and $1,005,000 of allocable contract costs in 2005.

*Example 7. CCM—contracts with disputes from taxpayer and customer claims.* C, who uses the CCM to account for exempt construction contracts and uses a calendar taxable year, constructs a factory for B pursuant to a long-term contract. Under the terms of the contract, B agrees to pay C a total of $1,000,000 for construction of the factory. C finishes construction of the factory in 1999 at a cost of $1,020,000. When B takes possession of the factory and begins operations in December 1999, B is dissatisfied with the location and workmanship of certain heating ducts. As of the end of 1999, C contends that the heating ducts as constructed are in accordance with contract specifications. The amount of the gross contract price reasonably in dispute with respect to the heating ducts is $6,000. As of this time, C is claiming $14,000 in addition to the original contract price for certain changes in contract specifications which C alleges have increased his costs. B denies that such changes have increased C's costs. In 2000 the disputes between C and B are resolved by performance of additional work by C at a cost of $1,000 and by an agreement that the contract price would be revised downward to $996,000. Under these circumstances, C must include in his gross income for 1999, $994,000 (the gross contract price less the amount reasonably in dispute because of B's claim, or $1,000,000-$6,000). In 1999, C must also take into account $1,000,000 of allocable contract costs (costs incurred less the amounts in dispute attributable to both B and C's claims, or $1,020,000-$6,000-$14,000). In 2000, C must take into account an additional $2,000 of gross contract price ($996,000-$994,000) and $21,000 of allocable contract costs ($1,021,000-$1,000,000).

(i) *Mid-contract change in taxpayer.* [Reserved]

* * * * *

Par. 8. Section 1.460–5 is revised to read as follows:

*§1.460–5 Cost allocation rules.*

(a) *Overview.* This section prescribes methods of allocating costs to long-term contracts accounted for using the percentage-of-completion method described in §1.460–4(b) (PCM), the completed-contract method described in §1.460–4(d) (CCM), or the percentage-of-completion/capitalized-cost method described in §1.460–4(e) (PCCM). Exempt construction contracts described in §1.460–3(b) accounted for using a method other than the PCM, CCM, or PCCM are not subject to the cost allocation rules of this section (other than the requirement to allocate production period interest under paragraph (b)(2)(v) of this section). Paragraph (b) of this section describes the regular cost allocation methods for contracts subject to the PCM. Paragraph (c) of this section describes an elective simplified cost allocation method for contracts subject to the PCM. Paragraph (d) of this section describes the cost allocation methods for exempt construction contracts reported using the CCM. Paragraph (e) of this section describes the cost allocation rules for contracts subject to the PCCM. Paragraph (f) of this section describes additional rules applicable to the cost allocation methods described in this section. Paragraph (g) of this section provides rules concerning consistency in method of allocating costs to long-term contracts.

(b) *Cost allocation method for contracts subject to PCM*—(1) *In general.* A taxpayer must allocate costs to each long-term contract subject to the PCM in the same manner that direct and indirect costs are capitalized to property produced by a taxpayer under §1.263A–1(e) through (h), except as otherwise provided in paragraph (b)(2) of this section. Thus, a taxpayer must allocate to each long-term contract subject to the PCM all direct costs and certain indirect costs properly allocable to the long-term contract (i.e., all costs that directly benefit or are incurred by reason of the performance of the long-term contract). However, see paragraph (c) of this section concerning an election to allocate contract costs using the simplified cost-to-cost method. As in section 263A, the use of the practical capacity concept is not permitted. See §1.263A–2(a)(4).

(2) *Special rules*—(i) *Direct material costs.* The costs of direct materials must be allocated to a long-term contract as of the earlier of when a direct material is purchased specifically for that contract or when dedicated, as defined in §1.263A–11(b)(2). For this purpose, a direct material is purchased specifically for a long-term contract if, when incurring the liability for the direct material, a taxpayer reasonably expects to incorporate the direct material in the subject matter of the contract. A taxpayer maintaining inventories under §1.471–1 must determine allocable contract costs attributable to direct materials using its method of accounting for such inventories (e.g., FIFO, LIFO, specific identification).

(ii) *Components and subassemblies.* The costs of a component or subassembly (component) produced by the taxpayer must be allocated to a long-term contract as the taxpayer incurs costs to produce the component if the taxpayer reasonably expects to incorporate the component into the subject matter of the contract. Similarly, the cost of a purchased component (including a component purchased from a related party) must be allocated to a long-term contract as the taxpayer incurs the cost to purchase the component if the taxpayer reasonably expects to incorporate the component into the subject matter of the contract. In all other cases, the cost of a component must be allocated to a long-term contract when the component is dedicated, as defined in §1.263A–11(b)(2). A taxpayer maintaining inventories under §1.471–1 must determine allocable contract costs attributable to components using its method of accounting for such inventories (e.g., FIFO, LIFO, specific identification).

(iii) Simplified production methods. A taxpayer may not determine allocable contract costs using the simplified production methods described in §1.263A–2(b) and (c).

(iv) *Costs identified under cost-plus long-term contracts and federal long-term contracts.* To the extent not otherwise allocated to the contract under this paragraph (b), a taxpayer must allocate any identified costs to a cost-plus long-term contract or federal long-term contract (as defined in section 460(d)). *Identified cost* means any cost, including a charge representing the time-value of money, identified by the taxpayer or related person as being attributable to the taxpayer's cost-plus long-term contract or federal long-term contract under the terms of the contract itself or under federal, state, or local law or regulation.

(v) *Interest*—(A) *In general.* If property produced under a long-term contract is *designated property,* as defined in §1.263A–8(b) (without regard to the exclusion for long-term contracts under §1.263A–8(d)(2)(v)), a taxpayer must allocate interest incurred during the production period to the long-term contract in the same manner as interest is allocated to property produced by a taxpayer under section 263A(f). See §§1.263A–8 to 1.263A–12 generally.

(B) *Production period.* Notwithstanding §1.263A–12(c) and (d), for purposes of this paragraph (b)(2)(v), the production period of a long-term contract–

(*1*) Begins on the later of–

(*i*) The contract commencement date, as defined in §1.460–1(b)(7); or

(*ii*) For a taxpayer using the accrual method of accounting for long-term contracts, the date by which 5 percent or more of the total estimated costs, including design and planning costs, under the contract have been incurred; and

(*2*) Ends on the date that the contract is completed, as defined in §1.460–1(c)(3).

(C) *Application of section 263A(f).* For purposes of this paragraph (b)(2)(v), section 263A(f)(1)(B)(iii) (regarding an estimated production period exceeding 1 year and a cost exceeding $1,000,000) must be applied on a contract-by-contract basis; except that, in the case of a taxpayer using an accrual method of accounting, that section must be applied on a property-by-property basis.

(vi) *Research and experimental expenses.* Notwithstanding §1.263A–1(e)(3)(ii)(P) and (iii)(B), a taxpayer must allocate research and experimental expenses, other than independent research and experimental expenses (as defined in section 460(c)(5)), to its long-term contracts.

(vii) *Service costs*—(A) S*implified service cost method*—(1) *In general.* To use the simplified service cost method under §1.263A–1(h), a taxpayer must allocate the otherwise capitalizable mixed service costs among its long-term contracts using a reasonable method. For example, otherwise capitalizable mixed service costs may be allocated to each long-term contract based on labor hours or contract costs allocable to the contract. To be considered reasonable, an allocation method must be applied consistently and must not disproportionately allocate service costs to contracts *expected to be completed in the near future.*

(2) *Example.* The following example illustrates the rule of this paragraph (b)(2)(vii)(A):

*Example. simplified service cost method.* During 1999, C, which uses a calendar taxable year, produces electronic equipment for inventory and enters into long-term contracts to manufacture specialized electronic equipment. C's method of allocating mixed service costs to the property it produces is the labor-based, simplified service cost method described in §1.263A–1(h)(4). For 1999, C's total mixed service costs are $100,000, C's section 263A labor costs are $500,000, C's section 460 labor costs (i.e. labor costs allocable to C's long-term contracts) are $250,000, and C's total labor costs are $1,000,000. To determine the amount of mixed service costs capitalizable under section 263A for 1999, C multiplies the "total mixed service costs" incurred during 1999 by its 1999 "section 263A allocation ratio" (section 263A labor costs/total labor costs). Thus, C's capitalizable mixed service costs for 1999 are $50,000 ($100,000 × $500,000/$1,000,000). Thereafter, C allocates its capitalizable mixed service costs to property produced remaining in ending inventory using its 263A allocation method (e.g., burden rate, simplified production). Similarly, to determine the amount of mixed service costs that are allocable to C's long-term contracts for 1999, C multiplies the "total mixed service costs" incurred during 1999 by its 1999 "section 460 allocation ratio" (section 460 labor/total labor costs). Thus, C's allocable mixed service contract costs for 1999 are $25,000 ($100,000 × $250,000/1,000,000). Thereafter, C allocates its allocable mixed service contract costs to each of its long-term contracts proportionately based on the 1999 section 460 labor costs allocable to each long-term contract.

(B) *Jobsite costs.* If an administrative, service, or support function is performed solely at the jobsite for a specific long-term contract, the taxpayer may allocate all the direct and indirect costs of that administrative, service, or support function to that long-term contract. Similarly, if an administrative, service, or support function is performed at the jobsite solely for the taxpayer's long-term contract activities, the taxpayer may allocate all the direct and indirect costs of that administrative, service, or support function among all the long-term contracts performed at that jobsite. For this purpose, *jobsite* means a production plant or a construction site.

(C) *Limitation on other reasonable cost allocation methods.* A taxpayer may use any other reasonable method of allocating service costs, as provided in §1.263A–1(f)(4), if, for the taxpayer's long-term contracts considered as a whole, the—

(*1*) Total amount of service costs allocated to the contracts does not differ significantly from the total amount of service costs that would have been allocated to the contracts under §1.263A–1(f)(2) or (3);

(*2*) Service costs are not allocated disproportionately to contracts expected to be completed in the near future because of the taxpayer's cost allocation method; and

(*3*) Taxpayer's cost allocation method is applied consistently.

(c) *Simplified cost-to-cost method*—(1) *In general.* Instead of using the cost allocation method prescribed in paragraph (b) of this section, a taxpayer may elect to use the simplified cost-to-cost method, which is authorized under section 460(b)(3)(A). Under the simplified cost-to-cost method, a taxpayer determines a contract's completion factor based upon only direct material costs; direct labor costs; and depreciation, amortization, and cost recovery allowances on equipment and facilities directly used to manufacture or construct the subject matter of the contract. An electing taxpayer must use the simplified cost-to-cost method to apply the look-back method under §1.460–6 and to determine alternative minimum taxable income under §1.460–4(f).

(2) *Election.* A taxpayer makes an election under this paragraph (c) by using the simplified cost-to-cost method for all long-term contracts entered into during the taxable year of the election on its original federal income tax return for the elec-

tion year. This election is a method of accounting and, thus, applies to all long-term contracts entered into during and after the taxable year of the election. This election is not available if a taxpayer does not use the PCM to account for all long-term contracts or if a taxpayer elects to use the 10-percent method described in §1.460–4(b)(6).

(d) *Cost allocation rules for exempt construction contracts reported using the CCM*–(1) *In general.* For exempt construction contracts reported using the CCM, other than contracts described in paragraph (d)(3) of this section, a taxpayer must annually allocate the cost of any activity that is incident to or necessary for the taxpayer's performance under a long-term contract. A taxpayer must allocate to each such exempt construction contract all direct costs as defined in §1.263A–1(e)(2)(i) and all indirect costs either as provided in §1.263A–1(e)(3) or as provided in paragraph (d)(2) of this section.

(2) *Indirect costs*—(i) *Indirect costs allocable to exempt construction contracts.* A taxpayer allocating costs under this paragraph (d)(2) must allocate the following costs to an exempt construction contract, other than a contract described in paragraph (d)(3) of this section, to the extent incurred in the performance of that contract–

(A) Repair of equipment or facilities;

(B) Maintenance of equipment or facilities;

(C) Utilities, such as heat, light, and power, allocable to equipment or facilities;

(D) Rent of equipment or facilities;

(E) Indirect labor and contract supervisory wages, including basic compensation, overtime pay, vacation and holiday pay, sick leave pay (other than payments pursuant to a wage continuation plan under section 105(d) as it existed prior to its repeal in 1983), shift differential, payroll taxes, and contributions to a supplemental unemployment benefits plan;

(F) Indirect materials and supplies;

(G) Noncapitalized tools and equipment;

(H) Quality control and inspection;

(I) Taxes otherwise allowable as a deduction under section 164, other than state, local, and foreign income taxes, to the extent attributable to labor, materials, supplies, equipment, or facilities;

(J) Depreciation, amortization, and cost-recovery allowances reported for the taxable year for financial purposes on equipment and facilities to the extent allowable as deductions under chapter 1 of the Internal Revenue Code (Code);

(K) Cost depletion;

(L) Administrative costs other than the cost of selling or any return on capital;

(M) Compensation paid to officers other than for incidental or occasional services;

(N) Insurance, such as liability insurance on machinery and equipment; and

(O) Interest, as required under paragraph (b)(2)(v) of this section.

(ii) Indirect costs not allocable to exempt construction contracts. A taxpayer allocating costs under this paragraph (d)(2) is not required to allocate the following costs to an exempt construction contract reported using the CCM–-

(A) Marketing and selling expenses, including bidding expenses;

(B) Advertising expenses;

(C) Other distribution expenses;

(D) General and administrative expenses attributable to the performance of services that benefit the taxpayer's activities as a whole (e.g., payroll expenses, legal and accounting expenses);

(E) Research and experimental expenses (described in section 174 and the regulations thereunder);

(F) Losses under section 165 and the regulations thereunder;

(G) Percentage of depletion in excess of cost depletion;

(H) Depreciation, amortization, and cost recovery allowances on equipment and facilities that have been placed in service but are temporarily idle (for this purpose, an asset is not considered to be temporarily idle on non-working days, and an asset used in construction is considered to be idle when it is neither en route to nor located at a job-site), and depreciation, amortization and cost recovery allowances under chapter 1 of the Code in excess of depreciation, amortization, and cost recovery allowances reported by the taxpayer in the taxpayer's financial reports;

(I) Income taxes attributable to income received from long-term contracts;

(J) Contributions paid to or under a stock bonus, pension, profit-sharing, or annuity plan or other plan deferring the receipt of compensation whether or not the plan qualifies under section 401(a), and other employee benefit expenses paid or accrued on behalf of labor, to the extent the contributions or expenses are otherwise allowable as deductions under chapter 1 of the Code. Other employee benefit expenses include (but are not limited to): worker's compensation; amounts deductible or for whose payment reduction in earnings and profits is allowed under section 404A and the regulations thereunder; payments pursuant to a wage continuation plan under section 105(d) as it existed prior to its repeal in 1983; amounts includible in the gross income of employees under a method or arrangement of employer contributions or compensation which has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or other plan deferring the receipt of compensation or providing deferred benefits; premiums on life and health insurance; and miscellaneous benefits provided for employees such as safety, medical treatment, recreational and eating facilities, membership dues, etc.;

(K) Cost attributable to strikes, rework labor, scrap and spoilage; and

(L) Compensation paid to officers attributable to the performance of services that benefit the taxpayer's activities as a whole.

(3) *Large homebuilders.* A taxpayer must capitalize the costs of home construction contracts under section 263A and the regulations thereunder, unless the contract will be completed within two years of the contract commencement date and the taxpayer satisfies the $10,000,000 gross receipts test described in §1.460–3(b)(3).

(e) *Cost allocation rules for contracts subject to the PCCM.* A taxpayer must use the cost allocation rules described in paragraph (b) of this section to determine the costs allocable to the entire qualified ship contract or residential construction contract accounted for using the PCCM and may not use the simplified cost-to-cost method described in paragraph (c) of this section.

(f) *Special rules applicable to costs allocated under this section*—(1) *Nondeductible costs.* A taxpayer may not allocate any otherwise allocable contract cost to a long-term contract if any section of the Code disallows a deduction for that type of payment or expenditure (e.g., an illegal bribe described in section 162(c)).

(2) *Costs incurred for non-long-term contract activities.* If a taxpayer performs a non-long-term contract activity, as defined in §1.460–1(d)(2), that is incident to or necessary for the manufacture, building, installation, or construction of the subject matter of one or more of the taxpayer's long-term contracts, the taxpayer must allocate the costs attributable to that activity to such contract(s).

(g) *Method of accounting.* A taxpayer that adopts or elects a cost allocation method of accounting (or changes to another cost allocation method of accounting with the Commissioner's consent) must apply that method consistently for all similarly classified contracts, until the taxpayer obtains the Commissioner's consent under section 446(e) to change to another cost allocation method.

Par. 9. Section 1.460–6 is amended as follows:

1. A sentence is added to the end of paragraph (a)(2).

2. In the third sentence of paragraph (b)(1), the language "by substituting '80 percent' for '50 percent' with" is removed and "by substituting 'at least 80 percent' for 'more than 50 percent' with" is added in its place.

3. The first sentence of paragraph (c)(1)(ii)(A) is revised.

4. The last two sentences of paragraph (c)(1)(ii)(B) are removed.

5. In the last sentence of paragraph (c)(1)(ii)(C)(2), the language "§5h.6" is removed and "§301.9100–8 of this chapter" is added in its place.

6. In the fourth sentence of paragraph (c)(2)(v)(A), the language "similarly" is removed.

7. The first, second, fifth, and sixth sentences of paragraph (c)(2)(v)(A) are removed.

8. In the first sentence of paragraph (c)(2)(vi)(B), the language "§1.451–3(b)(2)(ii), (iii), (iv), and §1.451–3(d)(2), (3), and (4)" is removed and "§1.460–4(b)(4)(i)" is added in its place.

9. In the second sentence of paragraph (c)(2)(vi)(B), the language "the percentage of completion method and" is removed.

10. In the third sentence of paragraph (c)(2)(vi)(B), the language ", for purposes of both the percentage of completion method and the look-back method" is removed.

11. In the fourth sentence of paragraph (c)(2)(vi)(B), the language "Similarly, a" is removed and "A" is added in its place.

12. In the first sentence of paragraph (c)(2)(vi)(C), the language "§1.451–3(e)" is removed and "§1.460–1(e)" is added in its place.

13. The heading of paragraph (c)(4)(iv) is revised and the last two sentences are revised.

14. In the first sentence of paragraph (d)(4)(ii)(C), the language " within the meaning of section 1504(a)" is removed and ", as defined in § 1.1502–1(h)" is added in its place.

15. In the fourth sentence of paragraph (e)(2), the language "within the meaning of section 1504(a)" is removed and ", as defined in §1.1502–1(h)" is added in its place.

The revisions and addition read as follows:

*§1.460–6 Look-back method.*

(a) * * *

(2) * * * Paragraph (j) of this section provides guidance concerning the election not to apply the look-back method in de minimis cases.

* * * * *

(c) * * *

(1) * * *

(ii) * * *

(A) *In general.* Except as otherwise provided in section 460(b)(6) or §1.460–6(e), a taxpayer must apply the look-back method to a long-term contract in the completion year and in any post-completion year for which the taxpayer must adjust total contract price or total allocable contract costs, or both, under the PCM. * * *

* * * * *

(4) * * *

(iv) *Additional interest due on look-back interest only after tax liability due.* * * * Unless a taxpayer is entitled to a tax refund that fully offsets the amount of look-back interest due the government, the look-back interest owed by the taxpayer compounds under section 6622 from the initial due date of the return (without regard to extensions) through the date the return, not the Form 8697, is filed. Similarly, if a taxpayer is entitled to receive look-back interest, the look-back interest compounds under section 6622 from the initial due date of the return (without regard to extensions) through the date the return, not the Form 8697, is filed.

* * * * *

**§§1.460–7 and 1.460–8 [Removed]**

Par. 8. Sections 1.460–7 and 1.460–8 are removed.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on April 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for May 5, 1999, 64 F.R. 24096)

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## Foundations Status of Certain Organizations

### Announcement 99–55

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

*Former Public Charities.* The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Abundant Life Enterprises Treatment Centers Inc., Bakersfield, CA
Acadiana Freenet, Lafayette, LA
Aeronautical Education Foundation Inc., Grand Prairie, TX
African Americans for the Alamo Defenders, San Antonio, TX
Animal Passion, Pittsburgh, PA
Ark, New York, NY
Arndt Family Foundation, Rochester, MN
Ascension Tabernacle Ministries of the Apostolic Faith, Dolton, IL

Asia Flight Assistance, Wenatchee, WA
Austen Foundation Inc., Ambridge, PA
Baton Rouge New Community Homes, Bassier City, LA
Bronx Alliance for the Inclusion of People with Disabilities, Bronx, NY
Buffalo-Duck River Resource Conservation & Development Association, Hohenwald, TN
C A T Canine Awareness Theft, Douglasville, GA
Centre for Business and Public Sector Ethics USA, Washington, DC
Citizens Against Homicide, San Rafael, CA
Construction Equipment Hall of Fame Inc., Northbrook, IL
Corporation for a Healthy Community, Anchorage, AK
Demos Youth Hockey Association, Hopkinton, MA
Economic National Underprivileged Foundation, Atlanta, GA
Environment in Focus Inc., Coral Gables, FL
Equal Rights Defense Fund Inc., St. Louis, MO
Eye on Africa Inc., Mount Vernon, NY
Firehouse Theatre Project Inc., Richmond, VA
First Choice Health Center, Detroit, MI
Fort Rucker Swim Team, Fort Rucker, AL
Foundation for the Perpetual Advancement of Human Dignity, Westlake Village, CA
Friends of Middlesex Fells Reservation Inc., Stoneham, MA
Friends of the Orchestra, Denton, TX
Future World Class Athletes Fund Inc., Wauwatosa, WI
Greg McLaughlin Evangelistic Ministries, Koshonong, MO
Hope Center, Chicago, IL
IBS Foundation International, Winston Salem, NC
Idaho Community Reinvestment Corporation, Boise, ID
International Center for Management Decisions Inc., Ithaca, NY
International Exposure, Boulder, CO
Irish American Hall of Fame, Coral Gables, FL
Its on Programs Inc., Pittsburgh, PA
Joseph M. Budzar Ministries, Inc., Lakewood, OH
La Crosse City Vision Foundation, Inc., La Crosse, WI
Laotian International Community Development Center of Rhode Island, Inc., Providence, RI
Leo Sowerby Foundation, Chicago, IL
Lewiston Rural Fire Service Incorporated, Lewiston, ID
Maine Charitable Foundation, Yarmouth, ME
Marching Black & Gold Inc., Indianapolis, IN
National Consumer Debt Counseling Services Inc., Reno, NV
National Rural Housing Foundation, Washington, DC
New Canaan Music Faculty Scholarship Fund, New Canaan, CT
New Jersey State Policemens Benevolent Association, Inc., Bergenfield, NJ
Pollution & Recycle Control Information Center, Baltimore, MD
Research Foundation for Educational Excellence, Oregon City, OR
San Joaquin Partnership Foundation, Inc., Stockton, CA
Saturday School for Children, St. Louis, MO
Seattle Pacific Education and Research Associates, Seattle, WA
Society for Learning Disabled Children, West Chester, PA
Spectrum Housing, Duncanville, TX
T L C Home for Adolescents Inc., Hot Springs, SD
T3CD Together Tarpon Terminates Chemical Dependency Inc., Clearwater, FL
Tabernacle of Testimony Sanctuary Ministries, Suitland, MD
Take Responsibility for Yourself Inc., Athens, OH
Tal Foundation, Mountain View, CA
Talbot County Public Housing Residents Association Incorporated, Woodland, GA
Talent Hut Players Inc., Seymour, CT
Tall City Baseball Association Inc., Midland, TX
Tall Ship Bounty Foundation Inc., Fall River, MA
Tam Cam Foundation, Inc., Greenwich, CT
Tamaras Hope Inc., Gilbert, AZ
Tampa Bay Friends for Life Education Fund Inc., Tampa, FL
Tampa PC Users Group Inc., Tampa, FL
Tara Project Inc., New York, NY
Task Force Against Substance Abuse Inc., Rumson, NJ
Taxpayers Network Inc., Cedarburg, WI
TC Miller Parent Teacher Organization, Lynchburg, VA
Tea Party Inc., Boston, MA
Teaching Youth to Lead by example, Maywood, IL
Team Ministries, Stockton, CA
Teen Care Peer Facilitators Inc., Greenfield, IN
Teen Opportunity Programs Inc., Bloomfield Hills, MI
Telecommunity Foundation, San Marcos, TX
Tell Our Youth Toy Inc., Austin, TX
Telluride Education Foundation Inc., Telluride, CO
Tempe Soccer Club Inc., Tempe, AZ
Temple House Inc., Baltimore, MD
Tenants United for Fairness-Vermont, Montpelier, VT
Tennessee Basic Trauma Life Support Inc., Knoxville, TN
Tennessee Coalition to Abolish State Killing, Nashville, TN
Tennessee Cooperative Baptist Fellowship, Chattanooga, TN
Tennessee Minority Purchasing Council Education Foundation, Nashville, TN
Tennessee Quarterly Inc., Nashville, TN
Tennessee Senior Games Inc., Nashville, TN
Tennis Association for Memphis Youth, Memphis, TN
Tercer Milenio Inc., Bronx, NY
Terra Incognita Limited, Leominster, MA
Terra Nova Project Inc., Boston, MA
Tewkesbury Abbey Appeal TR Inc., Tewkesbury, MA
Texans for Accountable Government, Austin, TX
Texas Association for Bilingual Education TABE, San Antonio, TX
Texas Association of Resource Conservation & Development Areas, Austin, TX
Texas Avenue Club Inc., Killeen, TX
Texas Center for Employment Services Inc., Houston, TX
Texas Centers for the Cultural Arts, Alpine, TX
Texas Childrens Wheelchair Clinic Inc., Lindale, TX
Texas Companion Animal Resource & Education Society, Dallas, TX
Texas Deaf Caucus, Dallas, TX
Texas Entrepreneurs Society, Houston, TX

Texas Karate Foundation Inc., Houston, TX
Texas Methadone Treatment Association Inc., Houston, TX
Texas Professional Peace Officers Association, Houston, TX
Texas Public Affairs Television Network Inc., Austin, TX
Texas Severe Storms Association Inc. TESSA, Arlington, TX
Texas Southern University School of Pharmacy Alumni Association Inc., Houston, TX
Texas Student Association, Denton, TX
Texas Tech Animal Science Alumni Association, Lubbock, TX
The A C Gilbert Foundation Inc., Erie, PA
The All Saints Memorial Foundation Inc., Tenafly, NJ
The American Quest, Fredericksburg, VA
The Angleton Volunteer Firefighters Association, Angleton, TX
The Anthony David Tony Wright Memorial Music Scholarship, Milwaukee, WI
The Archie Wooderson Eric Schultz Memorial Scholarship, Trinity, TX
The Association of Houston Audiologists, Houston, TX
The Baptist Banner Inc., Bumpass, VA
The Bayport-Blue Point Foundation Inc., Bayport, NY
The Biophysics Research Institute Inc., Ardsley, NY
The Bob Payette Memorial Animal Foundation Incorporated, Brighton, CO
The Bobby Foundation, Elmwood, MA
The Boys and Girls Club of Laytonville, Laytonville, CA
The Bristow Sports Complex Association Inc., Bristow, OK
The Carenet Foundation and Patient Registry Inc., Indianapolis, IN
The Caring Ones, Savoy, IL
The Carolina Alumni Club of Spartanburg, Spartanburg, SC
The Center for Depression Treatment and Research Inc., Belmont, MA
The Center for Educational and Social Services Inc., Deklab, IL
The Center for Global Community, Kansas City, MO
The Charles J Harlow Memorial Scholarship Fund Inc., Alexandria, VA
The Childrens Literacy Program, Washington, DC
The Class Notes, Ithaca, NY
The Classical Arts Center of Virginia, Newport News, VA
The Clinch Mountain Foundation Inc., Lebanon, VA
The Cutting Edge Publications, Phoenix, AZ
The Duckenfield Foundation Inc., Washington, DC
The Empowerment Foundation, Westlake, OH
The Equal Access Consumer Council Inc., New York, NY
The Family Foundation Inc., Austin, TX
The Following Ministries Inc., Mableton, GA
The Forest County Historical Society, Marienville, PA
The Foundation for AIDS Science and Treatment, Washington, DC
The Free Enterprise Foundation Inc., Little Rock, AR
The Friends of Newark School of Fine and Industrial Art Inc., Newark, NJ
The Friends of the Balch Dean Tavern Inc., Shrewsbury, MA
The Geneva City School Foundation Inc., Geneva, AL
The Great Millenium Peace Ride Inc., Tucson, AZ
The Harvest Institute, Bethesda, MD
The High Image Network, Richmond, VA
The Home Quarters Charitable Foundation, Virginia Beach, VA
The Hyde Park Senior Citizen Organization, Memphis, TN
The Islands Nonprofit Development Corporation, Detroit, MI
The James Madison Society Inc., Fredericksburg, VA
The Jewett Area Benevolent Fund Inc., Jewett, TX
The Jgenesis Corporation Inc., Atlanta, GA
The Joe Sandusky Foundation Inc., Sparks, MD
The Kentucky Center for Health Education Inc., Louisville, KY
The Lady Darling Heritage Foundation of America Inc., Southfield, MI
The Leadership Consortium of North Texas Area Colleges & Universities, Denton, TX
The Lollard Resource Center Inc., Dallas, TX
The Long Island Fund for the Environment Inc., Elmhurst, NY
The Love Foundation Inc., Goldenrod, FL
The Lucy Myers Urban Ministries Fund, Jacksonville, FL
The Methods of Motherhood M O M Foundation, Phoenix, AZ
The Michael A Battley Medical Foundation, Hazleton, PA
The Miller School Alumni Association Inc., Charlottesville, VA
The Millicent Fenwick Monument Association, Bernardsville, NJ
The Mountain Channel, Pine, CO
The Myth-Men, Washington, DC
The National Business Research Foundation Inc., Alexandria, VA
The National Center for Excellence in Education and Hall of Fame, Atlanta, GA
The Negro Baseball League Celebrations Inc., Voorhees, NJ
The North American Foundation for Modern Greek Art Inc., Baltimore, MD
The Oak Lawn Community Library Foundation Inc., Oak Lawn, IL
The Obedient Church of God Through Jesus Christ, Washington, DC
The Ogden-Weber Conference and Performing Arts Foundation, Ogden, UT
The Old Road Benevolent Society Inc., Fishkill, NY
The Patient Assistance Fund Inc., Durham, NC
The Patisse Foundation, New York, NY
The Peace Environmental Corporation, Carrollton, TX
The Peters Wish Foundation Inc., Grapevine, TX
The Praying Eagles Ministries, Orlando, FL
The Promises Inc., Terryville, CT
The Public Radio Service Inc., Columbia, MD
The Public Safety Foundation a New Jersey Nonprofit Corporation, Ramsey, NJ
The Publius Institute, Charlottesville, VA
The Railroad Museum of South Jersey Inc., Hammonton, NJ
The Rainbow Factory, Richmond, VA
The Rainbow Foundation, Charlottesville, VA
The Respite Family Care Center Inc., Doyelstown, PA
The Restoration Center Inc., Newark, NJ

The Rockaway Partnership Inc., Rockaway, NY
The Serving Line Inc., Elkridge, MD
The Society of the Classical Arts Inc., Wellington, FL
The Southern Arizona Burn Association Incorporated, Tucson, AZ
The Southwest Leadership Team Incorporated, Baltimore, MD
The Spirit of Truth Community Outreach Inc., Piscataway, NJ
The St. Johns Historical Event Corporation, Jacksonville, FL
The Tsavo West Bahai Institute, Austin, TX
The West Bank Neighborhood Improvement Association Inc., York, PA
The Will J Murphy African American Museum Foundation, Tuscaloosa, AL
The Womens Network and Resources Inc., Marshall, TX
Theatre Praxis Inc., Chicago, IL
Theatrix Unlimited Inc., Uniontown, PA
Therapeutic Riding Center of North West Arkansas, Bella Vista, AR
Theyre Almost There Scholarship and Loan Fund Inc., Towson, MD
Think Weather, Inc., Rockville, MD
Thinking Connections, Collins, MS
This Little Light, Everet, WA
Thomas Eakins House Cultural Center and Museum Inc., Philadelphia, PA
Thomas Jefferson High School Alumni Association, Dallas, TX
Thomas M Hennessy Scholarship Trust, N. Hampton, MA
Thomas Paine Foundation, Media, PA
Thomas T Goldsmith III Foundation Inc., Waldorf, MD
Thrift & Collectible Consignment Inc., Jacksonville, FL
Thunder Ministries Inc., Tulsa, OK
Thunder Soccer Club Inc., Fort Myers, FL
Tibetan Resettlement Project-Austin Inc., Austin, TX
Tiger Haven, Kingston, TN
Tiger Town Challengers, Cuyahoga Falls, OH
Time Out Adult Care Center Inc., Madison, NJ
Time-Out Inc., Geneva, AL
Timothy Awareness Institute for Human Services Inc., Hollywood, FL
Tiwahe Wawokiya Project, Sioux Falls, SD
To Seniors with Love Convalesce ADHC Center, Sacramento, CA
Tobacco Road Incorporated, Chicago, IL
Toyah Historical Society, Toyah, TX
United Women of Color for Change Inc., New York, NY
Unity House Apartments Inc., Morgantown, WV
Vatan Turkish American Association Inc., Gaithersburg, MD
Victory Temple Cogic Center, Chicago, IL
Washoe Parks Foundation, Reno, NV
Wesleyan Hill Community Development Corporation, Dayton, OH
Wilderness Experience Inc., Emerald Isle, NC
Women Who Write Inc., Chatham, NJ

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

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## Open Membership Application Period for the Information Reporting Program Advisory Committee

### Announcement 99–56

AGENCY: Internal Revenue Service (IRS), Treasury.

SUMMARY: In 1991 the Internal Revenue Service (IRS) established the Information Reporting Program Advisory Committee (IRPAC) at the request of the United States Congress. The primary purpose of IRPAC is to provide an organized public forum for discussion of relevant information reporting issues between officials of the IRS and representatives of the payer community. IRPAC offers constructive observations about current or proposed policies, programs, and procedures, and when necessary, suggests ways to improve the operation of the Information Reporting Program. IRPAC is currently comprised of 20 representatives from various segments of the private-sector payer community. About half of these appointments to IRPAC will expire at the end of 1999. Additional members will be selected for two-year terms beginning in January 2000. The IRS is interested in representation from different areas of the payer community.

SUPPLEMENTARY INFORMATION: IRPAC reports to the National Director, Office of Specialty Taxes, who is the executive responsible for ensuring and facilitating compliance by payers with information reporting requirements. IRPAC is instrumental in providing advice to enhance the IRP Program. Increasing participation by external stakeholders in the planning and improvement of the tax system will help achieve the goals of increasing voluntary compliance, reducing burden, and improving customer service. IRPAC members are not paid for their time or services, but consistent with Federal regulations, they will be reimbursed for their travel and lodging expenses to attend two public meetings each year. IRPAC members are expected to attend and pay their own way to four working sessions each year, which are generally held in Washington, DC. Occasionally, a meeting will be held in New York, NY; Martinsburg, WV; Austin, TX; or elsewhere.

Anyone wishing to be considered for membership on IRPAC should so advise the IRS. Please complete the following application questionnaire (or a facsimile thereof prepared on a word processor), and forward it to Ms. Kate LaBuda of the Office Payer Compliance, at the address below.

ADDRESSES: Internal Revenue Service, OP:EX:ST:PC, 1111 Constitution Avenue, NW, Room 2013, Washington, DC 20224.

DATES: Completed questionnaires (or facsimiles) should be received by IRS no later than Friday, June 3, 1999. Questionnaire received after this date will not be considered. An Acknowledgement letter will be sent upon receipt.

FOR FURTHER INFORMATION CONTACT: To have a copy of the application questionnaire mailed or faxed to you, please call Ms. Gloria Wilson at 202-622-4393 (not a toll-free number). For general information about the application process or IRPAC in general, call Kate LaBuda at 202-622-3404 (not a toll-free number).

Approved April 22, 1999.

Kate LaBuda,
*Acting Director, Office of Payer Compliance.*

Information Reporting Program Advisory Committee Membership Application Questionnaire

The following questions must be answered by anyone interested in becoming a member of the Information Reporting Program Advisory Committee (IRPAC). Applications (or facsimiles produced on a word processor) must be received at the address listed below by June 3, 1999. Those received after this date will not be considered. All applications received will be acknowledged. Questions may be directed to Kate LaBuda at 202-622-3404.

Ms. Kate LaBuda, OP:EX:ST:PC, Internal Revenue Service, Room 2013, 1111Constitution Avenue, NW, Washington, DC 20224.

1. Name: ______________________________

2. Title: ______________________________

3. Employer Name: ______________________________

4. Business Address: ______________________________

5. Business Phone: ______________________________

6. Fax Number: ______________________________

7. E-Mail Address: ______________________________

8. If you are applying on behalf of an organization or association other than your employer, please state the name, and address of that organization. Also provide a letter of reference from that organization stating you are nominated on their behalf to represent them. This letter should contain the name of a contact and this contact's phone number.

9. Home Address: ______________________________

10. Home Phone: ______________________________

11. Have you ever served on IRPAC or any other IRS advisory committee such as the Commissioner's Advisory Group (CAG), the Internal Revenue Service Advisory Council (IRSAC), the Electronic Tax Administration Advisory Committee (ETAAC), or any other one? If so, please explain. Do you currently have an application pending for membership on any other IRS advisory committee?

12. Check the one segment of the Information Reporting Program (IRP) payer community to which the organization that you represent, and your experience, most closely relate:

___ Real Estate
___ Transmitter/Forms Developer
___ Software Developer
___ Insurance: Property & Casualty
___ Insurance: Life
___ Insurance: Health
___ Securities
___ Mutual Funds
___ Payroll
___ State & Local Government
___ Corporate Compliance
___ Small Business Compliance
___ Public Accounting
___ Employee Plans
___ Trust Company
___ Corporate Transfer Agent/Utilities
___ Large Banks/Financial Institution
___ Small Banks/Financial Institution
___ Restaurant Industry
___ Other (Please specify. _________).

13. List the number of years of IRP-related experience you have, and specific sources of this IRP experiences. (Please account for all years of IRP experience claimed.)

14. List Professional credentials (e.g., PH.D., CPA, Enrolled Agent, Attorney, Accountant, etc.)

15. Identify organizations to which you belong and any relevant leadership positions you have held.

16. List any previous IRS employment (please state position(s), title(s), and time in each position):

17. Please propose two topic ideas that you feel would be appropriate for discussion by IRPAC. Include a short description (three sentences) of each topic.

The Following Three Items are Required for an FBI Name Check

18. Date of Birth: ______________________________________________________________

19. Place of Birth: ______________________________________________________________

20. Other names ever used: ________________________________________________________

The Following Items are Required for an IRS Tax Check. (Please Note That a Tax Check is Not a Tax Audit.)

The Internal Revenue Service will perform the standard Federal Advisory Committee member tax check, (pursuant to 26 U.S.C. 6103; 5 U.S.C. 1303; Executive Orders 9397, 11222, 10450; CFR 5.2; 31 CFR Part 0, Treasury Department Order Nos. 82 (Revised) and 150–87) and provide the information obtained to the Assistant Secretary (Administration) of the Treasury Department. The purpose of this tax check is to promote public confidence in the integrity of the Treasury Department and its administration of the Federal tax system. Your Social Security Number is required to identify your tax records accurately. This tax check must be completed prior to any appointment to this Federal Advisory Committee and you are now being asked to voluntarily provide the following information and, at a later time, you will be asked to sign a formal tax check waiver:

21. Social Security Number (SSN): _____________________________________________________

22. Spouse's name and SSN (if married and filing jointly): _______________________________________

The Following Item is Required Because of the Foreign Agents Registration Act (FARA), as Amended

23. I presently ______________ am / ____________ am not required to register as an agent of a foreign principal under FARA, as amended.

Note: Pursuant to 18 U.S.C. sec. 219, an individual who is required to register as an agent of a foreign principal under FARA is prohibited from serving on IRPAC. By executing this questionnaire, you agree that (1) if you are required to register as an agent of a foreign principal under the FARA before your term commences on IRPAC, you will terminate any and all such agencies prior to beginning your tenure and will provide appropriate verification therefor; and (2) you will immediately resign from IRPAC if you become such an agent at any time during your term.

Certification

24. I certify that, to the best of my knowledge and belief, all of my statements are true, correct, complete, and made in good faith. I also agree to the background checks set forth herein.

_____________________________________________
Signature

_____________________________________________
Date

(Filed by the Office of the Federal Register on April 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for May 3, 1999, 64 F.R. 23728)

## Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

*A*—Individual.
*Acq.*—Acquiescence.
*B*—Individual.
*BE*—Beneficiary.
*BK*—Bank.
*B.T.A.*—Board of Tax Appeals.
*C.*—Individual.
*C.B.*—Cumulative Bulletin.
*CFR*—Code of Federal Regulations.
*CI*—City.
*COOP*—Cooperative.
*Ct.D.*—Court Decision.
*CY*—County.
*D*—Decedent.
*DC*—Dummy Corporation.
*DE*—Donee.
*Del. Order*—Delegation Order.
*DISC*—Domestic International Sales Corporation.
*DR*—Donor.
*E*—Estate.
*EE*—Employee.
*E.O.*—Executive Order.
*ER*—Employer.
*ERISA*—Employee Retirement Income Security Act.
*EX*—Executor.
*F*—Fiduciary.
*FC*—Foreign Country.
*FICA*—Federal Insurance Contribution Act.
*FISC*—Foreign International Sales Company.
*FPH*—Foreign Personal Holding Company.
*F.R.*—Federal Register.
*FUTA*—Federal Unemployment Tax Act.
*FX*—Foreign Corporation.
*G.C.M.*—Chief Counsel's Memorandum.
*GE*—Grantee.
*GP*—General Partner.
*GR*—Grantor.
*IC*—Insurance Company.
*I.R.B.*—Internal Revenue Bulletin.
*LE*—Lessee.
*LP*—Limited Partner.
*LR*—Lessor.
*M*—Minor.
*Nonacq.*—Nonacquiescence.
*O*—Organization.
*P*—Parent Corporation.
*PHC*—Personal Holding Company.
*PO*—Possession of the U.S.
*PR*—Partner.
*PRS*—Partnership.
*PTE*—Prohibited Transaction Exemption.
*Pub. L.*—Public Law.
*REIT*—Real Estate Investment Trust.
*Rev. Proc.*—Revenue Procedure.
*Rev. Rul.*—Revenue Ruling.
*S*—Subsidiary.
*S.P.R.*—Statements of Procedral Rules.
*Stat.*—Statutes at Large.
*T*—Target Corporation.
*T.C.*—Tax Court.
*T.D.*—Treasury Decision.
*TFE*—Transferee.
*TFR*—Transferor.
*T.I.R.*—Technical Information Release.
*TP*—Taxpayer.
*TR*—Trust.
*TT*—Trustee.
*U.S.C.*—United States Code.
*X*—Corporation.
*Y*—Corporation.
*Z*—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1998–1 through 1998–52 will be found in Internal Revenue Bulletin 1999–1, dated January 4, 1999.

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Key to Abbreviations:

| | |
|---|---|
| RR | Revenue Ruling |
| RP | Revenue Procedure |
| TD | Treasury Decision |
| CD | Court Decision |
| PL | Public Law |
| EO | Executive Order |
| DO | Delegation Order |
| TDO | Treasury Department Order |
| TC | Tax Convention |
| SPR | Statement of Procedural Rules |
| PTE | Prohibited Transaction Exemption |

# EMPLOYEE PLANS



# EMPLOYEE PLANS—Continued



# EMPLOYMENT TAX



# EMPLOYMENT TAX—Continued



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